Canada Pension Plan

ANNUAL REPORT OF THE Canada Pension Plan 2002-2003

Government of Canada Gouvernement du Canada

Canada

ANNUAL REPORT OF THE CANADA PENSION PLAN

Fiscal Year 2002-2003

ISPB 202-11-04E

Produced by Human Resources Development Canada in collaboration with: the Department of Finance, the Canada Customs and Revenue Agency (CCRA), Public Works and Government Services Canada (PWGSC), and the Office of the Superintendent of Financial Institutions (OSFI).

If you require additional copies of this report, it is available for printing at: www.sdc.gc.ca

Or you may contact:

Publications
Social Development Canada
Ottawa ON
K1A 0L1
Fax: (613) 948-9450

Aussi disponible en français sous le titre *Rapport annuel du Régime de pensions du Canada 2002-2003*.

To suggest ways to improve the content or format of this report, please fill in our feedback form online at www.sdc.gc.ca under "Publications".

For more detailed information about subjects covered in this report, or about the Canada Pension Plan in general, please visit the Government of Canada's Income Security Programs website at: www.sdc.gc.ca

If you have questions, please call
(free of charge from Canada and the U.S.):

1 800 277-9914 (English)
1 800 277-9915 (French)
1 800 255-4786 (TTY)

Cat. No RH41-1/2003E
ISBN 0-662-36235-7

Government of Canada   Gouvernement du Canada

Her Excellency
The Governor General of Canada

May it please Your Excellency:

We have the pleasure of submitting the *Annual Report of the Canada Pension Plan* for the fiscal year 2002-2003.

Respectfully,

Ralph Goodale
Minister of Finance

Ken Dryden
Minister of
Social Development

Canada

Contents

During the period covered by this report, the Canada Pension Plan was administered by Human Resources Development Canada (HRDC). In December 2003, HRDC was divided into Social Development Canada (SDC) and Human Resources and Skills Development Canada. Responsibility for administration of the Plan now rests with SDC. At the same time, the Canada Customs and Revenue Agency became the Canada Revenue Agency.

This report on the Canada Pension Plan (CPP) consolidates input from all departments providing services on behalf of the Plan: Human Resources Development Canada (HRDC), the Department of Finance, the Canada Customs and Revenue Agency (CCRA), Public Works and Government Services Canada (PWGSC), and the Office of the Superintendent of Financial Institutions (OSFI).

2002-2003 The Year at a Glance

IN FISCAL 2002-2003:

- Federal and provincial finance ministers, as joint stewards of the Canada Pension Plan, completed their triennial financial review of the Plan in January 2003. The review, based on the findings of the *Eighteenth Actuarial Report*, confirmed that the combined 9.9 percent employer-employee contribution rate is sufficient to sustain the Plan for the next 75 years.
- 3.7 million Canadians received benefits from the Canada Pension Plan, with a total value of approximately $21.6 billion.
- 11.1 million people contributed to the CPP.
- 4.3 million people received Statements of Contributions.
- Administrative costs amounted to approximately $422 million, or 1.95 percent of the $21.6 billion in benefits paid. This compares favourably with administrative costs for other large pension plans and individual RRSPs.
- 2.9 million people received $15.1 billion in CPP retirement pensions.
- About 909,000 surviving spouses or common-law partners and 86,000 children of deceased contributors received over $3.3 billion in CPP benefits.
- About 283,000 persons with disabilities and 90,000 of their children received almost $3 billion in CPP disability benefits.
- On March 31, 2003, total CPP assets were valued at approximately $53.8 billion and equalled 2.5 years of benefits. The assets were held in provincial, territorial and federal government bonds, short-term investments, and domestic and foreign equities. Bonds are valued at cost and equities are valued at market valuation.
- Bill C-3 was introduced in Parliament in September 2002. It proposes to transfer all CPP assets to the CPP Investment Board. The Bill is the final step in implementing the investment changes agreed to by federal and provincial governments in the 1997 CPP reforms. [The Bill received Royal Assent on April 3, 2003.]
- The *Nineteenth Actuarial Report* was prepared by the Chief Actuary in response to Bill C-3. The Report concludes that transferring all Plan assets to the CPP Investment Board could increase CPP assets by about $85 billion over 50 years.
- Changes to the *Canada Pension Plan Regulations* were implemented on January 1, 2003, to reflect both the scheduled increase in the annual contribution rate to 9.9 percent and the statutory increase in maximum pensionable earnings ($39,900 for 2003). The contribution rate increase fully implements the 1997 reforms agreed to by the federal and provincial governments.

The Canada Pension Plan in Brief

Almost everyone who participates in the paid labour force in Canada contributes to the Canada Pension Plan (CPP) or to its sister plan, the Quebec Pension Plan (QPP), and will at some time benefit from their provisions.

Established by an act of Parliament in 1965 and implemented in 1966, the CPP is a jointly managed federal-provincial plan. Quebec manages and administers its own plan, the QPP, and participates in the decision making of the CPP. Benefits from either plan are based on pension credits accumulated under both. The plans are financed through mandatory contributions from employees, employers and self-employed people, as well as from investment income. (Information on the QPP is available from the Régie des rentes du Québec at www.rrq.gouv.qc.ca.)

While it is perhaps best known for its retirement pensions, the CPP also provides children's, survivor, disability and death benefits. The CPP administers the largest long-term disability plan in Canada. Vocational rehabilitation services offered under the Plan help some disability beneficiaries regain their independence by making it possible for them to return to the paid labour force, following a customized return-to-work plan.

Many Canadians live and work in other countries. Others move here after contributing to a public pension plan elsewhere. To help protect their pensions, Canada has entered into social security agreements with other nations. These agreements enable Canadians to receive public pensions from other countries and to receive CPP payments abroad. They also permit continuity of social security coverage when Canadians are temporarily working outside the country, eliminate duplicate contribution payments, and help them meet eligibility requirements for CPP and for other countries' public pensions.

Benefit calculations are based on how much and for how long a contributor has paid into the CPP. Benefits are not paid automatically – everyone must apply and provide proof of eligibility. However, once eligibility is determined, CPP benefits are paid even if the beneficiary also receives income from other sources. Benefits are adjusted in January of each year as needed to reflect increases in the average cost of living, as measured by the Consumer Price Index.

Financing the CPP

As joint stewards of the CPP, the federal and provincial ministers of Finance review the Plan's financial state every three years and make recommendations as to whether benefits and/or contribution rates should be changed. They base their recommendations on a number of factors, including the results of an examination of the Plan by the Chief Actuary. The Chief Actuary is required under the legislation to produce an actuarial report on the CPP every three years (in the year before the legislated ministerial review of the Plan). The CPP legislation also requires the Chief Actuary to prepare an actuarial report any time a Bill is introduced in Parliament that, in the view of the Chief Actuary, has a material impact on the estimates in the most recent triennial actuarial report. This is to ensure that the long-term financial implications of proposed Plan changes are given due consideration.

Changes to the CPP legislation governing the general level of benefits, the rate of contributions or the investment policy framework can be made only through an act of Parliament. All such changes require the agreement of at least two thirds of the participating provinces, representing at least two thirds of the population. The changes come into force only after two years' notice, unless all the provinces waive this requirement, and after Provincial Orders in Council confirming the changes have been passed. Quebec participates in decision making regarding changes to the CPP legislation, even though it has opted out of the CPP and administers its own plan. The Quebec Pension Plan must be involved in changes to the CPP if the two plans are to remain parallel.

In the fall of 2002, Bill C-3, *An Act to Amend the Canada Pension Plan and the Canada Pension Plan Investment Board Act*, was introduced in Parliament. The Bill is the final step in the investment changes agreed to by the federal and provincial ministers in 1997. The goal is to have CPP assets prudently invested in a diversified portfolio of securities at arm's length from government to better manage risk and return. The Bill enables the transfer of the bond portfolio and the operating balance (which are currently managed by the federal government) to the CPP Investment Board (CPPIB). Consolidating all assets in one professionally managed organization will allow the CPP Investment Board to determine the best asset mix and investment strategy. The intent is to enhance rates of return and improve risk management for plan members. [The Bill received Royal Assent in April 2003.]

The finance ministers announced the completion of their most recent triennial financial review of the CPP in January 2003. As part of the review, they agreed to leave the schedule of contribution rates unchanged. The *Eighteenth Actuarial Report*, which was prepared for the review, confirmed the financial sustainability of the Plan (taking into account the projected aging of Canada's population). Further information on the most recent report as well as previous reviews of the Plan can be found at **www.cpp-rpc.gc.ca**.

The most recent federal-provincial review confirms the success of the 1997 Canada Pension Plan reforms in putting Plan finances on a sustainable track.

It also recognizes the ongoing success of federal-provincial co-operation in this area. This should strengthen the confidence of Canadians in the future health of Canada's retirement income system, of which the Canada Pension Plan is an important part. The federal and provincial ministers must complete the next financial review of the Canada Pension Plan by the end of 2005.

ACTUARIAL REPORTING

The *Nineteenth Actuarial Report*, tabled in Parliament by the Minister of Finance in 2002, projects the effect of Bill C-3 on the long-term financial status of the CPP. As required by the legislation, the Chief Actuary used the same assumptions and methods as in the *Eighteenth Actuarial Report* (prepared for the most recent triennial financial review of the plan). These were modified to take into account the proposed legislative change.

In the *Nineteenth Actuarial Report*, the Chief Actuary concludes that the legislated contribution rate (9.9 percent in 2003 and thereafter) should be sufficient to pay for future expenditures. The rate is also expected to accumulate assets of $1,578 billion by 2050, or 5.9 times annual Plan expenditures. The transfer of the bond portfolio and operating balance to the CPP Investment Board is expected to contribute a projected $85 billion over 50 years to asset accumulation. According to the Chief Actuary, the anticipated pool of assets should make it possible to absorb any unforeseen economic or demographic fluctuations without an increase in the contribution rate. Such fluctuations would otherwise have required an increase in the contribution rate above 9.9 percent. The *Nineteenth Actuarial Report* can be found at **www.osfi-bsif.gc.ca/eng/office/actuarial reports/index.asp**, as can previous actuarial reports.

The *Eighteenth Actuarial Report* was tabled in Parliament by the Minister of Finance in December 2001. It provides an actuarial examination of the Plan as at December 31, 2000. The Report was reviewed by a panel of independent actuaries, and their conclusions should give Canadians confidence in the actuarial projections on the CPP. The panel concluded that the Report is based on economic and demographic assumptions that are reasonable in the aggregate (though somewhat on the conservative side). It also stated that the Report meets current professional standards of actuarial practice and uses data and methodologies that are appropriate and reasonable. In addition to its conclusions, the panel made a number of recommendations regarding the preparation of future actuarial reports. The panel's report and recommendations can be found at **www.osfi-bsif.gc.ca/eng/office/actuarial reports/index.asp**.

A FAIR APPROACH TO FUNDING

When it was introduced in 1966, the CPP was designed as a pay-as-you-go plan, with a small reserve. This meant that the benefits for one generation would be paid largely from the contributions of later generations. This approach made sense under the economic, financial and demographic circumstances of the time. The period was characterized by a rapid growth in wages and labour-force participation, and low rates of return on investments.

The federal and provincial governments decided to keep contributions at a reasonable level while beginning to pay full retirement benefits as early as the mid-1970s. This was important – many of the seniors who received benefits at that time had been unable to accumulate sufficient retirement savings.

However, demographic and economic developments and changes to benefits in the 30 years that followed resulted in significantly higher costs. When federal and provincial finance ministers began their five-year statutory review of the CPP finances in 1996, contribution rates, already legislated to rise to 10.1 percent by 2016, were expected to have to rise again – to 14.2 percent by 2030 – to continue to finance the Plan on a pay-as-you-go basis.

Continuing to finance the Plan on a pay-as-you-go basis would have meant imposing a heavy financial burden on Canadians in the workforce 25 years down the road, which was deemed unacceptable by the federal and provincial governments. Therefore, in 1997, they agreed instead to change the funding approach of the Plan to a hybrid of pay-as-you-go and full funding. Under full funding, each generation pays for its own benefits.

Steady-state financing

To reduce the burden on future generations, the federal and provincial governments introduced "steady-state" financing in 1998. This approach requires that contribution rates be set no lower than the lowest rate expected to ensure the long-term financial stability of the Plan without recourse to further rate increases. At the time of the reforms, this was determined to be 9.9 percent. Therefore, under steady-state financing, the contribution rate was scheduled to increase incrementally (from 5.6 percent in 1996) to 9.9 percent in 2003, and to remain at this level thereafter.

Steady-state financing will generate a level of contributions between 2001 and 2020 that exceeds the benefits paid out every year during this period. Funds not immediately required to pay benefits will be transferred to the CPP Investment Board for investment. As a result, Plan assets will cover an increasing number of years of expenditures over this period. Over time, this will create a large enough reserve to help pay the growing costs that are expected as more and more "baby boomers" begin to collect their retirement pension.

After 2020, as the last of the baby boomers retire, and benefits paid begin to exceed contributions, investment revenues from the CPP's accumulated assets will provide the funds necessary to make up the difference. However, contributions will remain the main source of funding for benefits.

The steady-state financing approach adopted in 1998 is a cross between full funding and pay-as-you-go. Moving to a full-funding approach would have created unfairness across the generations. During the transition, contributors of some generations would have paid higher contributions than others –

they would have had to pay for the benefits of current retirees and for the development of a reserve to cover their own pensions. A pure pay-as-you-go approach would also have been unfair, as it would have meant a sharp increase in the contribution rate over the coming decades.

A partially funded CPP not only balances the two approaches to funding, but also contributes to diversifying the funding of Canada's retirement income system:

- the Old Age Security program, funded by federal government revenues, and
- private savings, including tax-deferred, fully funded employer-sponsored pension plans and registered retirement savings plans (RRSPs).

A diversified funding approach allows Canada's retirement income system to be less vulnerable to changes in economic and demographic conditions than are systems in countries that use a single funding approach. In addition, the Canadian approach to pension provision, based on a mix of public and private pensions, is an effective way to provide for retirement income needs, according to international organizations.

Financial Accountability

Since 1999-2000, the CPP has used the accrual basis of accounting for revenues and expenditures. This method gives administrators a detailed financial picture and allows accurate matching of revenue and expenditures in the year in which they occur.

As at March 31, 2003, total CPP assets were valued at approximately $53.8 billion (equal to 2.5 years' worth of benefits). Net plan assets are contributions and investment income that have accumulated since the Plan's inception in 1966 – less benefit and administrative expenditures over the same period. Plan assets are expected to increase appreciably over the next 20 years.

CPP ACCOUNT

A separate account, the CPP Account, has been established in the accounts of the Government of Canada to record the financial elements of the Plan: contributions, interest, pensions and other benefits paid, and administrative expenditures. The CPP Account also records the amounts transferred to or received from both the CPP Investment Fund and the CPP Investment Board. Spending authority is limited to the Plan's net assets. The CPP Account is not part of the federal government's revenues and expenditures.

For the year ending March 31, 2003, the CPP Account's operating balance was maintained at a level designed to cover three months' worth of forecast benefit payments and administrative charges. The CPP legislation currently requires the operating balance to be maintained at this level at all times. When Bill C-3 (*An Act to Amend the Canada Pension Plan and the Canada Pension Plan Investment Board Act)* comes into force, the CPPIB will assume responsibility for CPP cash management and will determine the appropriate level of short-term Plan assets to meet the liquidity needs for investment and benefit payments.

During 2002-03, the cash operating balance earned a weighted average interest rate of 2.64 percent, or $169 million.

CPP INVESTMENT FUND

Before the 1998 changes to the CPP's investment policy, funds not immediately needed to pay benefits and maintain liquidity in the CPP Account were invested only in long-term bonds of the provincial and territorial governments, provincial Crown agencies, and the Government of Canada. All securities held were invested for 20-year terms. The balance in the Investment Fund on March 31, 2003, was $26.6 billion, down from $28.3 billion in March 2002 because of non-renewal of maturing bonds.

Since 1998, funds coming into the Plan that are not immediately needed to pay benefits and Investment Fund securities that are redeemed have been transferred to the CPP Investment Board to be invested in capital markets. As a transitional measure, all provinces and territories can roll over their CPP borrowings at maturity for one additional 20-year term if they wish, at the same rate of interest as they would pay on their other market borrowings at the same time.

During the 1999 federal-provincial triennial review, a decision was made to amend the CPP legislation. The amendment gives the provinces and territories the option of prepaying some or all of their CPP borrowings at market rates of interest, at no cost to the Plan. This option, which was implemented in January 2001, can assist provinces that wish to accelerate the repayment of their debt.

Interest

In 2002-03, the Investment Fund earned about $2.7 billion in interest, which was deposited in the CPP Account. This compares with $3 billion earned in the previous 12 months. The Canada Pension Plan Financial Statements summarize the status of the Investment Fund as at March 31, 2003 (see page 19).

Maturing securities are redeemed by the federal government, provinces and territories as they come due. In 2002-03, $2.4 billion worth of bonds matured; of those, the provinces and territories renewed $680 million for an additional 20-year term.

Rates of return

The Investment Fund continues to benefit from the high rates of return for securities that were bought in the early 1980s when interest rates were relatively high. These securities are 20-year government bonds bearing a weighted average annual nominal return of 9.93 percent. The Fund's average nominal rate of return can be expected to remain above 8 percent for the next several years. For this reason, the short-term rate of return, based on these investments, will exceed the Fund's expected long-term rate of return of 6.5 percent, or 3.5 percent after inflation.

CPP INVESTMENT BOARD

The CPP Investment Board (CPPIB) was created by an Act of Parliament in December 1997 to invest funds not required by the Canada Pension Plan to pay current benefits.

On March 31, 2003, the market value of assets invested by the CPPIB in Canadian and foreign equities and real estate totalled $17.5 billion, which represented about 32 percent of the Plan's assets. The CPPIB's annual report and its quarterly financial statements can be found at **www.cppib.ca**.

The Board operates at arm's length from government and is overseen by an independent board of directors. Its legislated mandate is to manage funds transferred from the CPP "in the best interests of the contributors and beneficiaries of the Plan." The Board is to "invest its assets with a view to achieving a maximum rate of return, without undue risk of loss." The CPPIB must also consider the factors that affect the Plan's funding and its ability to meet its financial obligations.

In developing its asset mix policy, the CPPIB considers the Plan's fixed income assets (the bond portfolio and operating balance), which are currently administered by the Department of Finance. As a result, the Board is building a diversified portfolio to balance the existing government bonds and is investing in public and private equities and real estate. It will also consider infrastructure investments in the future.

The CPPIB has a long-term investment horizon. The Chief Actuary estimates that contribution revenues will exceed CPP benefit payments and expenses well into the future, and that the CPP will not need money from the Board for 18 years.

Further information on the CPPIB's mandate, structure and investment policy can be found on its website.

Current investments

As at March 31, 2003, the CPPIB's $17.5 billion in assets were invested as follows: 63 percent in Canadian public equity markets, 24 percent in public equity markets in the United States, Europe and Asia, 9 percent in Canadian and non-Canadian private equities, 2 percent in real estate, and 2 percent in short-term liquid assets.

The CPPIB has full discretion within the framework provided by the legislation over its investment policy. It is subject to the foreign property rule under the *Income Tax Act* and may invest up to 30 percent of the book value of its assets outside Canada. Its equity portfolios are now managed in-house to reduce costs and to help with the management of its passively invested portfolios.

As of March 31, 2003, the CPPIB had committed $5.1 billion to private equity investments and actually invested $1.5 billion, or approximately 9 percent of the CPPIB's total assets, in private equities.

The CPPIB initiated its exposure to real estate with investments in publicly traded real estate companies and privately-held real estate totalling $313 million.

During the 2002-03 fiscal year, the CPPIB's equity and real estate portfolio lost $4.1 billion, representing a rate of return of negative 21.1 percent.

The CPPIB has stated that this type of short-term volatility is expected, is within risk parameters, and has no impact on current CPP benefits. It sees a more relevant perspective as the long-term goal of building a diversified portfolio to enhance long-term returns and mitigate risk to help sustain the CPP over the next 20 to 50 years.

Investing for our future

The CPPIB has expanded into private equities through externally managed funds that provide venture capital and expansion financing to private companies. It expects to commit as much as 10 percent of total equities to private equities and 5 percent to other private market investments such as real estate and infrastructure. These investments will be made through limited partnerships or pooled funds managed by investment firms in Canada and around the world.

In compliance with its statutory requirement to hold a public meeting in each participating province at least once every two years, the Board held public meetings in the provincial capitals in January 2001 and June 2002.

Benefits and Expenditures

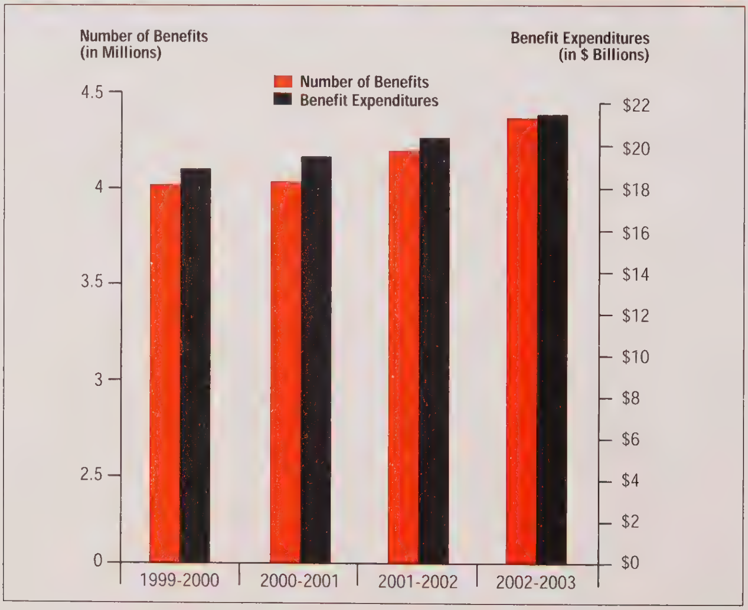
The number of people receiving CPP benefits has increased steadily over the past decade. To pay for these benefits, expenditures have also increased. Figure 1 shows the yearly increases since 1999-2000. Figure 2 shows the percentage of CPP expenditures by type of benefit.

RETIREMENT PENSIONS

Retirement pensions represent 66 percent of the total number of CPP benefits paid and 70 percent of the total benefit dollars paid out by the CPP in 2002-03. The amount of each contributor's pension depends on how much and how long he or she has contributed and at what age he or she begins to draw the benefits. In March 2003, the monthly maximum retirement pension was $801.25; the average payment was $447.18.

The CPP offers flexibility with respect to the age of retirement. Seniors can take their pension as early as the age of 60 or as late as 70. The CPP permanently reduces the pension by 0.5 percent per month for those who take their benefit before their 65th birthday, reflecting the fact that these seniors will, on average, receive their benefit longer than someone who retires at the age of 65. For those who take their benefit after their 65th birthday, the CPP permanently increases the pension by 0.5 percent per month, reflecting the fact that these seniors will receive their benefit for a shorter amount of time on average. The adjustments are intended to ensure that there is no advantage or disadvantage from taking the retirement benefit at a particular age. The Chief Actuary of the Canada Pension Plan completed a study on this issue in March 2003.

Figure 1 – BENEFITS AND EXPENDITURES BY FISCAL YEAR



The study is available at **www.osfi-bsif.gc.ca/eng/office/actuarialinstructions/index.asp**.

DISABILITY BENEFITS

Disability benefits, paid to eligible contributors and their children, represent 9 percent of the total number of CPP benefits paid and 14 percent of the total benefit dollars paid out by the CPP in 2002-03. In March 2003, the maximum monthly disability benefit was $971.26; the average payment was $729.61. The children's monthly benefit was a flat rate of $186.71.

SURVIVOR BENEFITS

Survivor benefits, paid to the surviving spouse or common-law partner of the contributor and his/her dependent children, represent 23 percent of the total number of CPP benefits paid and 15 percent of the total benefit dollars paid out by the CPP in 2002-03. The amount of the monthly survivor benefit varies depending on a number of factors, including the age of the spouse or common-law partner at death and whether the beneficiary also receives other CPP benefits.

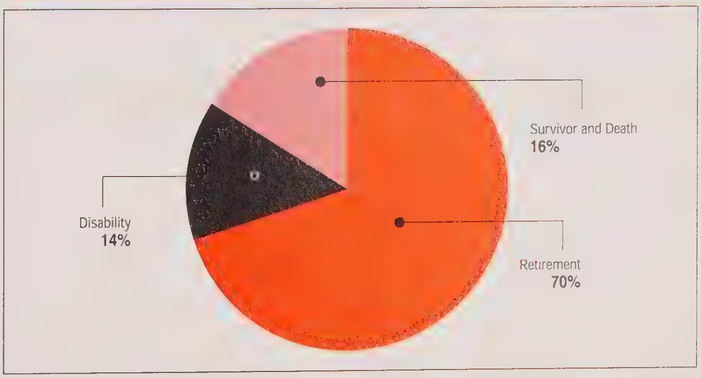
DEATH BENEFITS

Death benefits represent 2 percent of the total number of CPP benefits paid and 1 percent of the total benefit dollars paid out by the CPP in 2002-03. The death benefit is a one-time payment. The maximum payable is $2,500; the average payment in March 2003 was $2,201.49.

OTHER PROVISIONS

The CPP includes provisions that compensate for periods of low earnings, namely the child-rearing drop-out provision (CRDO) and the 15 percent general drop-out provision. The CRDO allows the CPP to drop up to seven years of low or zero earning (due to child rearing) from the calculation of a contributor's CPP disability, survivor and/or retirement benefit. The 15 percent general drop-out provision is for low or zero earning years and applies to all contributors. The Plan has other provisions under which married or common-law spouses may either share their pensions (if the union is intact), or split their credits (if the union has dissolved). If you wish to know more about these, see our contact information on the inside front cover of this report.

Figure 2 – PERCENTAGE OF BENEFIT DOLLARS PAID FOR 2002-03



Improved Service Delivery

REACHING OUT TO CANADIANS

During 2002-03, HRDC continued its efforts to help Canadians better understand public pensions and the retirement income system, and to encourage them to actively plan and prepare for their own retirement. Information on the CPP is available in print, on the Internet, in person at local offices, by phone, and at electronic kiosks in government offices and public buildings.

Personalized contact with clients continued to receive high priority. In 2002-03, HRDC issued personal CPP Statements of Contributions to more than 4.3 million contributors between the ages of 18 and 70. The statements were accompanied by information on the retirement income system in Canada.

DELIVERING SERVICE

In 2002-03, HRDC focused on maintaining the CPP information technology systems and continuing to modernize CPP program delivery in conjunction with information technology renewal.

Major systems-related initiatives gave CPP staff better online access to contributors' record-of-earnings information and the ability to correct client information online.

New data storage and retrieval features have been added to improve support to external partners, such as provincial social services departments and workers' compensation boards. These changes have improved client service and the speed with which benefits can be adjudicated and inquiries answered.

Work also continues on the rules-based system – a knowledge base to guide the decision-making process and ensure that legislation, operational policy and procedures are correctly and consistently applied.

PROCESSING BENEFITS

CPP services are offered in person, by telephone and by mail. In 2002-03, staff received 57,383 disability applications (which are complex and require medical information). These applications were processed within an average of 68 working days each. Retirement applications, comprising the majority of applications received, were processed within 26 days (see Table 1 below).

Improved communication with clients and their physicians helped staff make well-informed decisions and helped CPP disability applicants better understand the reasons for decisions. As a result, close to 90 percent of the applications for disability benefits in 2002-03 were finalized in the initial stages.

TABLE 1 – SPEED OF PROCESSING NEW APPLICATIONS

National speed-of-service measures	Objective	2002-03 National Average
Number of working days to process initial CPP applications* (excluding disability applications)	28	26
Number of working days to process initial CPP disability applications	62	68

*Number of days between the date the application is received and the date of the decision.

HRDC call centres received over 2 million calls about the CPP in 2002-03. Positive responses to the mail-out of personalized statements to CPP contributors and inquiries during the traditionally busy T4 period contributed to the high number of calls. Despite higher call volumes, service to clients improved. In 2002-03, enhanced call management allowed for improved telephone service. Results show in the reduction of client waiting time and a significant increase in the speed of service.

TABLE 2 – TELEPHONE SERVICE STATISTICS*

	2001-02	2002-03
Percentage of clients served by a service agent within 180 seconds of placing a call**	81.9%	96.3%
Average waiting time to speak with a service agent	61 sec.	20 sec.
Average time clients spend talking to a service agent	244 sec.	237 sec.

* Table includes CPP and Old Age Security totals. Speed of service does not vary between programs.
** The objective is to serve clients within 180 seconds for 95 percent of calls.

Managing the CPP

COLLECTING AND RECORDING CONTRIBUTIONS

Contributions to the CPP are paid on earnings between a minimum and a maximum amount. The minimum (which remains constant) is $3,500 and the maximum is adjusted annually to reflect the growth in the average Canadian industrial wage. The maximum amount of pensionable earnings as of January 1, 2003, was $39,900 (up from $39,100 in 2002). Contributions stop once a contributor reaches the age of 70 or begins to receive a CPP retirement pension or disability benefit.

The contribution rates for the year 2003 are 4.95 percent for employees and 4.95 percent for employers. People who are self-employed pay both portions, for a total of 9.9 percent. Employers and employees make approximately 94 percent of contributions and the remaining 6 percent comes from the self-employed.

All CPP contributions are remitted to the Canada Customs and Revenue Agency (CCRA). In 2002-03, contributions amounted to $25.2 billion.

CCRA also assesses and verifies earnings and contributions, advises employers and employees of their rights and responsibilities, conducts audits, and reconciles reports and T4 slips. To verify that contribution requirements are being met, CCRA applies a compliance and enforcement process that can vary from a computerized data match to an on-site audit. There are approximately 1.5 million existing employer accounts. During 2002-03, CCRA conducted 64,278 audits, concentrating on files with irregularities.

ADMINISTRATIVE COSTS

In 2002-03, it cost approximately $422 million to administer the CPP, with HRDC accounting for the largest portion – $328 million (see Table 3 on page 15). CCRA required approximately $80 million and Public Works and Government Services Canada (PWGSC) $13 million, for services to the CPP. The Office of the Superintendent of Financial Institutions (OSFI), where the Office of the Chief Actuary is housed, and the Department of Finance incurred costs of $993,000 and about $500,000, respectively.

Since the administrative costs of the CPPIB are drawn from CPPIB investment income, they are reported in that organization's annual report. This is consistent with the arm's-length administration of the Board. In 2002-03, the CPPIB reported $12.9 million in investment and administrative expenses.

CPP administrative expenses in 2002-03 represent 1.95 percent of the $21.6 billion in benefits paid. This ratio compares very favourably with that of other pension plans. Administrative costs, for example, average 5 percent of expenditures for large pension plans in the private sector that operate under a trust agreement. These tend to be the larger private plans in terms of both membership and asset size. CPP administrative costs also compare favourably with those of RRSPs.

Table 3 presents the CPP's administrative expenditures for the last three years.

TABLE 3 – CPP ADMINISTRATIVE COSTS 2000-01 TO 2002-03

	Expenditures (in $ thousands)		
Department/Agency	**2000-01**	**2001-02**	**2002-03**
Human Resources Development Canada	$242,562	$279,156	$328,268
Canada Customs and Revenue Agency	77,746	77,618	80,229
Public Works and Government Services Canada	12,810	12,440	12,823
Office of the Superintendent of Financial Institutions	1,102	1,061*	993*
Finance Canada	395	492	495
Total	$334,615	$370,767	$422,808

* Amounts reflect actual expenses attributable to each fiscal year.

THE APPEALS PROCESS

There are three opportunities for review of a person's CPP benefit application (as shown on page 16). Most requests for review concern an application for disability benefits.

The first involves a request to the Minister of Human Resources Development for a reconsideration (or administrative review) of a decision concerning a benefit or a division of pension credits. The number of requests for reconsideration in disability cases declined slightly from 12,649 in 2000-01 to 12,092 in 2001-02, but increased slightly to 12,461 in 2002-03. The number of benefits awarded at reconsideration remained relatively unchanged from 2001-02 to 2002-03, declining from 28 percent to 27 percent.

A person who is not satisfied with the decision made at the departmental reconsideration level can appeal to a Review Tribunal. A Review Tribunal is an independent, impartial body made up of three people chosen by the Commissioner of Review Tribunals from a panel of some 300 part-time members appointed by Cabinet. The Review Tribunal heard 5,182 appeals during 2002-03. The grant rate at the Review Tribunal level was 48 percent in 2002-03.

The final opportunity for review is the Pension Appeals Board (PAB) – a tribunal operating at arm's length from HRDC. Board members are judges or former judges of the federal court or a superior court of a province. Hearings are not automatic at this level; claimants or the Minister of Human Resources Development must request "leave to appeal". Of the 1,219 applications for leave to appeal received in 2002-03, some 95 percent concerned CPP disability benefits. In 2002-03, some 62 percent of the applications received by the PAB were granted.

THE APPEALS PROCESS

INITIAL DECISION

Human Resources Development Canada (HRDC) issues a decision on CPP benefit eligibility.

If the client is not satisfied with the decision, he or she can submit a request for reconsideration to the Minister of Human Resources Development.

FIRST LEVEL OF REVIEW
Review of client file and decision issued by HRDC

If the client is not satisfied with the decision, he or she has 90 days to appeal to the Office of the Commissioner of Review Tribunals.

SECOND LEVEL OF REVIEW
Appeal to the Office of the Commissioner of Review Tribunals

The case is heard and a decision is issued.

If either the client or HRDC is not satisfied with the decision, an application for "Leave to Appeal" may be submitted to the Pension Appeals Board.

THIRD LEVEL OF REVIEW
Appeal to the Pension Appeals Board

If leave is granted, the case is heard and a decision is issued.

The decision of the Pension Appeals Board is final, subject to judicial review by the Federal Court of Canada.

HRDC continues to work with the Office of the Commissioner of Review Tribunals and the Pension Appeals Board to improve co-ordination and response times and to identify opportunities for the earliest possible resolution of appeals.

Looking to the Future

Some 300,000 new CPP applications are received each year and a significant increase is expected as our population ages. The challenge will be to improve service delivery to ensure that Canadians continue to receive timely, accurate and client-focused service. Long-term initiatives aimed at meeting that challenge are now underway.

CPP ONLINE

CPP Online will support the objectives of the federal Government On-Line (GOL) initiative (the commitment to provide Canadians with full electronic access to key federal information and services by 2005). CPP Online initiatives include the implementation of a Web-based system that allows a wider range of inquiries and client transactions online. Six client groups – seniors, persons with disabilities, survivors, migrants, low-income pensioners, and contributors – will be the focal point for modernizing CPP service delivery over the decade. In this context, the importance of strengthening our technological framework is clear, especially since the fastest-growing group of Internet users is the seniors' population.

HRDC has made it a priority to update the systems that help deliver benefits. Evolving over the next four years, the systems will support better decision making by improving the information available to management, clients and staff through faster and more up-to-date technology. The improvements will further reduce the paper burden and the complexity of the application process.

Putting CPP information online is a multi-year project designed to provide Canadians with online access to information, data, and services essential to income security and retirement planning. A comprehensive review of legislation, regulations, policies, and procedures will lay the groundwork for an innovative, leading-edge approach to online services.

ONLINE SERVICES

Over the next two years, HRDC will offer a number of online service options for access to information and services that are essential to income security and retirement. These services will include:

Self-service options by Internet

In 2004, CPP clients will have secure online access to their personal information. They will be able to view and update their address and direct-deposit information online. The enhancement of these capabilities will continue, allowing more information to be viewed and updated in coming years.

Streamlined and automated CPP Statement of Contributions

CPP contributors can now submit an online request to receive a copy of their Statement of Contributions by mail. In 2004, they will be able to view Statement of Contributions information online.

Tax Information Slips Online

As of early 2004, CPP clients can view their CPP T4 slips online, starting with those for the 2003 taxation year.

SIMPLIFYING THE APPLICATION PROCESS

Simplifying the application process for the CPP retirement pension is part of HRDC's planned service delivery improvements. The goal is to make the application process easier for clients through streamlined, client-driven and more effective services.

Making it easier to apply for the CPP retirement pension will be the first step in building a modern service system that is based on Canadians' needs and expectations. It will reduce the need for complex information and documentation, replacing them with online applications. As part of this initiative, services allowing clients to apply for benefits online are being introduced.

[**Editor's note:** Since July 2003, a simplified CPP retirement application has been available for clients to fill out online. Currently, they are required to print, sign and mail this form to HRDC along with their birth evidence. Efforts will be made to take the onus off clients for providing documentation such as birth certificates.]

REACHING ALL CANADIANS

HRDC's programs help millions of people in Canada every day. The Department's primary objective is that every Canadian receive the benefits to which he or she is entitled under its programs.

There has been a dramatic decline in the low-income rate among Canadian seniors in recent decades. This is due in large part to the existence of public pensions such as the CPP.

Over the past several years, HRDC has made a concerted effort to tell Canadians what they can expect from their public pensions and how they should prepare for their own retirement. Striving to communicate as directly as possible, the CPP will continue improving and personalizing its programs to reach its clients.

The Internet has a tremendous ability to reach Canadians. HRDC leads the development of a cross-departmental website called Canada Benefits (**www.canadabenefits.gc.ca**). The site's mandate is to provide central access to government-wide financial benefit programs for individuals.

The Canada Benefits site provides information and lists services such as pensions, employment insurance and housing. The information and services are from federal, provincial and territorial government departments, Crown corporations and agencies. The award-winning website supports the "citizen-first" principle – information is organized for and made available to Canadians who need it.

Since its update in January 2003, the Canada Benefits site has experienced significant success, receiving an average of 48,000 visitors monthly. Initially launched in November 2001 with federal information, the site was expanded in January 2003 to include links to provincial and territorial information. A tool called the "Benefits Finder" provides citizens with a listing of programs relevant to their circumstances.

Through the Canada Benefits site and other means of communication, HRDC has been able to reach more Canadians than ever. Based on the firm conviction that all Canadians deserve financial security, HRDC strives to make them aware of the benefits available and helps them obtain those to which they are entitled.

Canada Pension Plan

Financial Statements

for the year ended March 31, 2003

Management's responsibility for financial statements

The financial statements of the Canada Pension Plan have been prepared by management of Human Resources Development Canada in accordance with the Canadian generally accepted accounting principles.

Management is responsible for the integrity and objectivity of the data in these financial statements, including the amounts which must, of necessity, be based on best estimates and judgements. The financial information presented throughout the Annual Report is consistent with the financial statements.

In support of its responsibility, management has developed and maintains books of account, financial and management controls, information systems and management practices. These are designed to provide reasonable assurance as to the reliability of the financial information, and to ensure that the transactions are in accordance with the *Canada Pension Plan* and regulations, as well as the *Financial Administration Act* and regulations.

The Auditor General of Canada, the external auditor of the Canada Pension Plan, has conducted an independent audit of the financial statements in accordance with Canadian generally accepted auditing standards and has reported to the Minister of Human Resources Development Canada.

Assistant Deputy Minister
Financial and Administrative Services

Janet Milne

Associate Deputy Minister

M. Flu

Maryantonett Flumian

October 1st, 2003

AUDITOR GENERAL OF CANADA VERIFICATEUR GÉNÉRAL DU CANADA

AUDITOR'S REPORT

To the Minister of Human Resources Development Canada

I have audited the statement of net assets of the Canada Pension Plan as at March 31, 2003 and the statement of changes in net assets and cash flow for the year then ended. These financial statements are the responsibility of the management of Human Resources Development Canada. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audit in accordance with Canadian generally accepted auditing standards. Those standards require that I plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In my opinion, these financial statements present fairly, in all material respects, the financial position of the Canada Pension Plan as at March 31, 2003 and the changes in its net assets and its cash flow for the year then ended in accordance with Canadian generally accepted accounting principles.

Sheila Fraser

Sheila Fraser, FCA
Auditor General of Canada

Ottawa, Canada
October 1st, 2003

Statement of Net Assets
as at March 31

	2003	2002
		Restated (Note 4)
		(in millions of dollars)
Assets		
Investments		
CPP Investment Fund – at cost (Note 5)		
Provincial and Territorial bonds	**23,204**	24,890
Canada bonds	**3,369**	3,386
CPP Investment Board – at fair value (Note 6)	**17,453**	14,289
Cash		
Deposit with Receiver General for Canada	**7,093**	6,770
Receivables		
Contributions	**1,631**	1,378
Accrued interest	**939**	1,030
Régime des rentes du Québec	**66**	25
Beneficiaries (Note 7)	**49**	43
	53,804	51,811
Liabilities		
Accounts payable	**74**	47
Accrued pensions and benefits	**55**	51
CPP Investment Board's liabilities, net of its other assets	**2**	4
	131	102
Net Assets	**53,673**	51,709
Net Assets, represented by:		
Canada Pension Plan Investment Fund	**26,573**	28,276
Accumulated transfers to Canada Pension Plan Investment Board	**21,690**	14,372
Accumulated net loss from Investment Board's operations	**(4,239)**	(87)
Canada Pension Plan Account (Note 8)	**7,093**	6,770
CPP receivables, net of liabilities	**2,556**	2,378
Net Assets	**53,673**	51,709

The accompanying notes are an integral part of these financial statements.

Approved by Human Resources Development Canada:

Assistant Deputy Minister
Financial and Administrative Services

Janet Milne

Associate Deputy Minister

M. Flu

Maryantonett Flumian

Statement of Changes in Net Assets
for the year ended March 31

	2003	2002
		Restated (Note 4)
		(in millions of dollars)
Net assets, beginning of year	51,709	46,014
Increase in assets		
Contributions (Note 9)	**25,203**	22,991
Investment Income / (loss) (Note 10)	(1,242)	3,565
	23,961	26,556
Decrease in assets		
Pensions and Benefits		
Retirement	**15,071**	14,270
Survivors	**3,071**	2,933
Disability	**2,779**	2,641
Disabled Contributor's Child	**251**	242
Death	**234**	227
Orphan	**210**	205
Net overpayments	(41)	(28)
	21,575	20,490
Administration costs (Note 11)	**422**	371
	21,997	20,861
Increase in net assets	**1,964**	5,695
Net assets, end of year	53,673	51,709

The accompanying notes are an integral part of these financial statements.

Statement of Cash Flow
for the year ended March 31

	2003	2002
	(in millions of dollars)	
Cash Flow Provided by Operating Activities		
Cash Receipts:		
Contributions	**24,950**	23,354
Interest from CPP Investment Fund	**2,839**	3,166
Interest on Deposit with Receiver General for Canada	**163**	202
Recoveries from Régime des rentes du Québec	**192**	214
Recoveries from beneficiaries	**37**	32
	28,181	26,968
Cash Payments:		
Pensions and Benefits	**(21,613)**	(20,516)
Repayments to Régime des rentes du Québec	**(235)**	(217)
Administration costs	**(395)**	(375)
	(22,243)	(21,108)
	5,938	5,860
Cash Flow From (Used in) Investing Activities		
Transfers to CPP Investment Board	**(7,318)**	(6,826)
Disposals of bonds – CPP Investment Fund	**2,383**	2,369
Reinvestments in bonds – CPP Investment Fund	**(680)**	(1,053)
	(5,615)	(5,510)
Net increase in the Deposit with Receiver General for Canada	**323**	350
Deposit with Receiver General for Canada, beginning of year	**6,770**	6,420
Deposit with Receiver General for Canada, end of year	**7,093**	6,770

The accompanying notes are an integral part of these financial statements.

Notes to financial statements March 31, 2003

1. DESCRIPTION OF THE CANADA PENSION PLAN

a) Description of the CPP

The Canada Pension Plan (CPP) is a federal/provincial plan established by an Act of Parliament in 1965.

The CPP began operations in 1966. It is a compulsory and contributory social insurance program operating in all parts of Canada, except Quebec, which operates the Régime des rentes du Québec, a comparable program. The Plan's objective is to provide a measure of protection to workers and their families against the loss of earnings due to retirement, disability or death.

The Minister of Human Resources Development Canada is responsible for the administration of the *Canada Pension Plan* (the CPP Act); the Minister of National Revenue is responsible for collecting contributions. The Minister of Finance and his provincial counterparts are responsible for setting CPP contribution rates, pension and benefit levels and funding policy.

The financial activities of the Canada Pension Plan are recorded in the CPP Account (Note 8). The CPP Investment Fund (Note 5) holds the bond portfolio of the Plan, and the Plan's investments in capital markets are managed by the CPP Investment Board (Note 6). The financial transactions affecting the Account and the Investment Fund are governed by the CPP Act and regulations. The Investment Board's transactions are governed by the *Canada Pension Plan Investment Board Act* and the accompanying regulations.

As stated in the CPP Act, changes to this Act require the approval of at least two-thirds of the provinces having, in the aggregate, not less than two-thirds of the population of all included provinces.

b) Financing

CPP is financed by contributions and investment returns.

Employers and employees pay contributions equally to CPP. Self-employed workers pay the full amount.

CPP was designed initially to be financed on a pay-as-you-go basis, which means that the Plan would operate on a current basis with pensions and benefits being paid out of current contributions. With changes made to the Act in 1997, CPP is now intended to be funded on a "steady-state" basis – that is, combined contributions increased to 9.9% of pensionable earnings in 2003 and are expected to level off.

From 1966 to 1986, the combined employer-employee contribution rate remained at 3.6% of pensionable earnings. In 1987, it was raised to 3.8% and increased yearly by 0.2% to reach 5.6% in 1996. In the years 1997 to 2002, the combined contribution rate was increased annually to reach 9.9% in 2003. The maximum combined contribution for 2003 was $3,604 (2002 – $3,346).

The CPP Act provides that an actuarial report shall be prepared every three years for purposes of the review of the financial state of the CPP by the Minister of Finance and his provincial counterparts. The *Eighteenth Actuarial Report* of the Chief Actuary of the Office of the Superintendent of Financial Institutions done as at December 31, 2000 was presented to the Minister of Finance in December 2001, then tabled in the House of Commons on December 10, 2001. Based on this report, federal and provincial ministers of Finance concluded at the end of the 2002 Triennial Review process that the CPP is financially sound and that the 9.9% combined employee-employer contribution rate reached in 2003 is expected to be sufficient to sustain the Plan in the face of an aging population. A number of assumptions such as long term rate of return on assets, inflation rate, mortality rates, increase in salary and benefit rates, among other things, were used in the 18th CPP actuarial report. These assumptions reflect best estimates of future economic and demographic events. The next actuarial report as at December 31, 2003 is expected to be completed by December 2004.

c) Net assets of the Plan

The net assets of the Plan are composed of the deposit with the Receiver General for Canada, short term investments, long term investments in bonds held by the CPP Investment Fund and investments managed by the CPP Investment Board. The net assets represent funds accumulated for the payment of pensions, benefits and administration costs. This amount does not cover the actuarial present value of accrued pensions and benefits. As at March 31, 2003, the net assets of the Plan are of $53.7 billion (2002 – $51.7 billion). This amount represents approximately 2.5 times the total of pensions and benefits for the year 2002-2003.

d) Pensions and benefits

Retirement pensions – A retirement pension is payable to each contributor at age 60 or older, according to the provisions of the Act. The monthly amount is equal to 25% of the contributor's average monthly pensionable earnings during the pensionable period. The amount may be reduced or increased depending upon whether the contributor applies for a retirement pension before or after age 65. This adjustment cannot exceed 30%. The maximum new monthly pension payable at age 65 in 2003 is $801.25 (2002 – $788.75).

Disability benefits – A disability benefit is payable to a contributor who is disabled, according to the provisions of the Act. The amount of the disability benefit to be paid includes a flat-rate portion and an amount equal to 75% of the earned retirement pension. The maximum new monthly disability benefit in 2003 is $971.26 (2002 – $956.05).

Survivor's benefits – A survivor's benefit is payable to the spouse or common-law partner (the beneficiary) of a deceased contributor, according to the provisions of the Act. For a beneficiary under the age of 65, the benefit consists of a flat-rate portion and an amount equal to 37.5% of the deceased contributor's earned retirement pension. A beneficiary between the ages of 35 and 45 who is not disabled or who has no dependent children receives reduced benefits. For beneficiaries aged 65 and over, the benefit is equal to 60% of the retirement pension granted to the deceased contributor. The maximum new monthly benefit payable to a beneficiary in 2003 is $480.75 (2002 – $473.25).

Disabled contributor's child and orphan benefits – According to the provisions of the Act, each child of a contributor who is receiving disability benefits or who died is entitled to a benefit as long as the child is under the age of 18, or is between the ages of 18 and 25 and attending school full-time. The flat-rate monthly benefit in 2003 is $186.71 (2002 – $183.77).

Death benefits – According to the provisions of the Act, a death benefit is a one-time payment to, or on behalf of, the estate of a contributor. The benefit amounts either to 10% of the maximum pensionable earnings in the year of death or six times the monthly retirement pension granted to the deceased contributor, whichever is less. The maximum death benefit in 2003 is $2,500 (2002 – $2,500).

Pensions and benefits indexation – As required by the Act, pensions and benefits are indexed annually based on the Consumer Price Index for Canada. The rate of indexation for 2003 is 1.6% (2002 – 3.0%).

2. SIGNIFICANT ACCOUNTING POLICIES

a) Basis of presentation

These financial statements present the financial position, the changes in net assets and the cash flows of the Canada Pension Plan. They include the financial position of the CPP Investment Board and the results of its operations. These financial statements are prepared in accordance with Canadian generally accepted accounting principles and conform to the disclosure and accounting requirements of the CPP Act.

These financial statements do not provide information on the actuarial estimates required to meet future obligations of the CPP since the CPP Act does not require that the pensions and benefits be pre-funded.

The CPP, which is under joint control of the Government of Canada and participating provinces, is not considered to be part of the reporting entity of the Government of Canada. Accordingly, its financial activities are not consolidated with those of the Government.

b) Valuation of investments

Bonds are shown at cost, which is equal to the face value of the bonds at the time of purchase. This accounting policy has been selected based on the non-marketable, non-transferable nature of the bonds and on consideration of the likelihood of redemption of the provincial and territorial bonds in the foreseeable future. The bonds issued by the provincial and territorial governments are redeemable prior to maturity at market value equivalent at the option of these governments. In the event that the federal Minister of Finance considers the redemption necessary to pay pensions, benefits and administration costs, the bonds would then be redeemed at face value.

CPP Investment Board's investments are stated at fair value. Fair value is the amount of the consideration that would be agreed upon in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act. Quoted market prices for publicly traded equities and unit values for pooled funds are used to represent fair value for the investments. Unit values reflect the quoted market prices of the underlying securities.

In the case of private equity investments, where quoted market prices are not available, fair value is determined annually, commencing after the first year of ownership, based on carrying values and other relevant information reported by external managers of the limited partnerships in which the investments are made. These carrying values are determined by the external managers using accepted industry valuation methods.

The fair value of private market investments in income producing properties is determined annually, commencing after the first year of ownership, using accepted industry valuation methods, such as discounted cash flows and comparable purchase and sales transactions.

Fair value for the over-the-counter derivatives such as swaps is determined based on discounted cash flows and market prices for underlying assets with similar characteristics.

Money market securities are recorded at cost which, together with accrued interest income, approximates fair value.

c) **Contributions** to the Plan include CPP contributions for pensionable income earned and collected by the Canada Customs and Revenue Agency (CCRA) for the year and receivable at year-end. Contributions collected by the CCRA are measured from amounts assessed by the CCRA and from estimates of amounts not assessed based on cash received and are subject to review and adjustments. Adjustments, if any, are recorded as contributions in the year they are known.

d) Investment income recognition

Interest income is recorded in the year in which it is earned.

CPP Investment Board's net income from operations represents the Investment Board's investment income, less investment and administrative expenses. Investment income is recorded on the accrual basis and includes realized gains and losses on disposal or transfer of investments, unrealized gains and losses on investments held at the end of the year, dividend income (recognized on ex-dividend date), interest income, distributions from mutual and pooled funds, and net operating income from private market real estate investments.

Realized gains and losses on investments sold during the year represent the difference between sale proceeds and cost, less related costs of disposition. Unrealized gains and losses represent the change year-over-year in the difference between fair value and cost of investments.

e) Translation of foreign currencies

Transactions in foreign currencies are recorded at the rates of exchange prevailing on the transaction date. Investments denominated in foreign currencies and held at the year end are translated at exchange rates in effect at the year end date. The resulting realized and unrealized gains and losses are included in investment income.

f) Pensions and benefits are recorded when payable.

g) Net overpayments are composed of overpayments of pensions and benefits that were established during the year less remissions of debts granted.

h) Administration costs are recorded in the year to which they relate.

i) Measurement uncertainty

The preparation of financial statements in accordance with the Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities as at the date of the financial statements and revenue and expenses for the year. Actual results could differ from these estimates. The most significant estimates are related to contributions, administration costs, allowance for doubtful accounts and the fair value of the bonds held by the CPP Investment Fund.

3. CHANGE IN BASIS OF ACCOUNTING

During the year, the CPP adopted Canadian generally accepted accounting principles as the basis of presentation of its financial statements.

This change resulted in the addition of a statement of cash flow to the existing set of financial statements.

4. CHANGE IN ACCOUNTING POLICY

During the year, the methodology used to measure contributions was changed to conform with the new assessment-based methodology developed by the Government of Canada for determining tax revenues, CPP contributions and Employment Insurance premiums. The new methodology is further described in Note 9.

Prior to 2002-2003, contributions were measured using an economic/statistical methodology developed by the Department of Finance including many factors such as the growth in the number of contributors and the average pensionable earnings.

This change in accounting policy has been applied retroactively and the 2001-2002 financial statements have been restated accordingly. The effect of the change for contributions on the current year and previous year's results is presented below:

Year ended and as at March 31	**2003**	2002
	(in millions of dollars)	
	Increase (Decrease)	
Statement of Changes in Net Assets		
Contributions	**160**	(542)
Net Assets	**160**	(542)
Net Assets, beginning of year	**(216)**	326
Net Assets, end of year	**(56)**	(216)
Statement of Net Assets		
Contribution receivables	**(56)**	(216)

5. INVESTMENTS HELD BY THE CPP INVESTMENT FUND

The Canada Pension Plan Investment Fund was established in the accounts of Canada by the CPP Act to record the Plan's investments in bonds of the provinces, territories and Canada. The CPP Investment Fund's bond portfolio is administered by the federal Department of Finance.

Until the end of 1997, the investments in provincial, territorial and federal government bonds were made with the cash on hand in excess of the Plan's forecast three-month operating requirement. These bonds were not marketable and had a 20-year term (or less) as fixed by the Minister of Finance on the recommendation of the Chief Actuary of the Office of the Superintendent of Financial Institutions. The interest rate on the bonds was determined by the Minister of Finance based on the average yield to maturity of all outstanding Government of Canada obligations with terms of 20 years or more. When these bonds matured, funds not required for payment of pensions and benefits were re-invested in new bonds.

Beginning in 1998, a maturing provincial or territorial bond may be re-invested in a new bond only once for a term of 20 years, if both the issuer asks to do so and the operating balance is sufficient to pay current pensions and benefits. Excess funds not re-invested are transferred to the CPP Investment Board.

The re-invested bonds remain not marketable and bear interest at a rate fixed by the Minister of Finance. The interest rate is substantially the same rate that the province would pay if it were to borrow the same amount for the same term through the issuance of a bond on the public capital markets. Interest earned on the investments is paid semi-annually to the CPP Account.

During the year, all disposals of bonds were made, at maturity date, at face value. The bonds are redeemable in whole or in part before maturity. Since January 31, 2001, the provinces and territories are permitted to redeem their bonds held by the CPP Investment Fund prior to their maturity at a value equivalent to market value. The bonds can also be redeemed at the option of the federal Minister of Finance where he considers the redemption necessary to pay pensions, benefits and administration costs. The bonds are then redeemed at face value. No bonds were redeemed by the provinces and the territories prior to maturity during the year ended March 31, 2003.

At March 31, 2003, the balance in the Investment Fund was $26.6 billion at cost (2002 – $28.3 billion). The estimated fair value of the balance in the Investment Fund, including accrued interest, is $32.6 billion (2002 – $34.3 billion). This estimate is calculated by discounting the bonds' contractual cash flows at rates currently available at year-end for similar investments.

The following schedule provides information on the disposals, re-investments and balance of the Investment Fund.

Bonds, at cost

(in millions of dollars)

	March 31, 2002	Disposals	Re-Investments	**March 31, 2003**
Newfoundland	633	52	52	**633**
Prince Edward Island	140	11	11	**140**
Nova Scotia	1,173	94	–	**1,079**
New Brunswick	834	73	73	**834**
Quebec	96	5	5	**96**
Ontario	11,944	1,236	38	**10,746**
Manitoba	1,260	132	–	**1,128**
Saskatchewan	1,219	110	42	**1,151**
Alberta	3,560	275	100	**3,385**
British Columbia	4,027	378	359	**4,008**
Yukon Territory	4	–	–	**4**
	24,890	2,366	680	**23,204**
Canada	3,386	17	–	**3,369**
	28,276	2,383	680	**26,573**

The following schedule presents the bonds by maturity dates and the weighted-average annual rate of return on bonds currently held.

	2003	(in millions of dollars)	2002	
	Investments at cost	**Average yield**	Investments at cost	Average yield
Investments maturing				
Within 1 year	**2,499**	**11.77%**	2,383	14.80%
1 – 5 years	**9,700**	**10.99%**	10,020	11.46%
Over 5 years	**14,374**	**8.90%**	15,873	9.13%
Total – Investments	**26,573**		28,276	
Weighted-average yield on investments		**9.93%**		10.43%

6. INVESTMENTS HELD BY THE CPP INVESTMENT BOARD

The Canada Pension Plan Investment Board (CPPIB) was established by an Act of Parliament in 1997. The *Canada Pension Plan Investment Board Act* came into force on April 1, 1998. The purpose of the Board is to invest the funds transferred by the CPP in a diversified portfolio of investments. The Board is designed to operate at arm's length from the government. It is required to be accountable to the public, Parliament (through the federal Minister of Finance), and the provinces and provides regular reports of its activities and the results achieved.

The following schedule provides information on the Board's investments as at March 31.

	2003	2002
	(in millions of dollars)	
Canadian equities, at fair value		
Public Markets	**11,051**	9,825
Private Markets	**261**	144
	11,312	9,969
Non-Canadian equities, at fair value		
Public Markets	**4,245**	3,832
Private Markets	**1,265**	316
	5,510	4,148
Total Equities (Cost 2003 – $20,336; 2002 – $14,546)	**16,822**	14,117
Real Return Assets		
Public markets real estate	**219**	145
Private markets real estate	**246**	–
Total Real Return Assets (Cost 2003 – $645; 2002 – $145)	**465**	145
Money Market Securities (Cost 2003 – $575; 2002 – $27)	**575**	27
Investment Receivables (Cost 2003 – $41; 2002 – Nil)	**41**	–
Investment Liabilities (Cost 2003 – $452; 2002 – Nil)	**(450)**	–
Total Net Investments	**17,453**	14,289

The CPP Investment Board has established investment policies which set out the manner in which assets shall be invested. In determining the asset mix, the CPPIB takes into consideration certain assets of the CPP which are held outside the CPP Investment Board.

In accordance with its Investment Policy, at least 70% of the book value of the CPP Investment Board's portfolio is allocated to Canadian investments and the remainder to non-Canadian investments.

The CPPIB's investments are mainly allocated to equities. During the current year, the CPP Investment Board sold units held in index pooled and mutual funds and purchased the individual securities underlying the funds. The CPP Investment Board also obtains exposure to real estate through investments in publicly traded securities and privately held real estate. Private real estate investments are held by a subsidiary and are managed on behalf of the CPP Investment Board by external advisors and managers through co-ownership arrangements.

The CPPIB limits credit risk by dealing with counterparties that have a minimum credit rating of A or R-1 (short term) as determined by a recognized credit rating agency, where available, or as determined through an internal credit rating process. Credit exposure is limited to maximum amounts approved by the Board of Directors.

The CPP Investment Board is exposed to currency risk through holdings of non-Canadian investments and investment receivables. Investments are not hedged against changes in foreign exchange rates.

The CPP Investment Board is exempt from Part I tax under paragraph 149 (1) (d) of the *Income Tax Act (Canada)* on the basis that all of the shares of the CPP Investment Board are owned by Her Majesty in right of Canada. The CPP Investment Board's subsidiaries are exempt from Part I tax under paragraph 149(1)(d.2) of the *Income Tax Act (Canada)* on the basis that all of the shares of the subsidiaries are owned by a corporation whose shares are owned by Her Majesty in right of Canada.

The CPP Investment Board's audited financial statements for the year ended March 31, 2003 are publicly available and provide details concerning the Board's investment policy, its investments and portfolio return.

7. RECEIVABLES FROM BENEFICIARIES

	2003	2002
	(in millions of dollars)	
Balance of pensions and benefits overpayments	77	73
Allowance for doubtful accounts	(28)	(30)
	49	43

Human Resources Development Canada has procedures to detect overpayments. During the year, overpayments totalling $45 million (2002 – $38 million) were established and remissions of debts totalling $4 million (2002 – $10 million) were granted. A further $37 million was recovered (2002 – $32 million).

8. CANADA PENSION PLAN ACCOUNT

The CPP Account was established in the accounts of Canada by the CPP Act, to record the contributions, interest, pensions, benefits and administration costs of the Plan. It also records the amounts transferred to or received from the CPP Investment Fund and the CPP Investment Board.

The balance of the CPP Account includes the Deposit with Receiver General for Canada and short-term investments, if any. As at March 31, the Deposit with Receiver General for Canada amounts to $7,093 million (2002 – $6,770 million).

9. CONTRIBUTIONS

As indicated in Note 4, contributions for the year are measured by Canada Customs and Revenue Agency (CCRA). Contributions are measured based on amounts assessed and reassessed by CCRA at the time of preparation of its financial statements and an estimate of contributions for the period that were not yet assessed or reassessed at that time based on cash amounts received.

Actual results may differ from these estimates. Actual contribution amounts for calendar years 2002 and 2003 will only be known once the CCRA has processed all employers' and self-employed workers' declarations of contributions for these years. An adjustment for the variation between actual and estimated contributions will be recorded in the fiscal year in which the adjustment is known.

10. INVESTMENT INCOME/(LOSS)

	2003	2002
	(in millions of dollars)	
Interest on bonds held by the CPP Investment Fund	**2,741**	3,071
Interest on deposit with the Receiver General for Canada at a weighted-average annual rate of 2.64% (2002 – 3.09%)	**169**	189
Investment Board net income/(loss) from operations:		
Net unrealized gains/(losses)	**(3,264)**	459
Fund distributions of capital gains and dividends	**361**	213
Net realized losses	**(1,533)**	(378)
Dividend Income	**288**	12
Other investment income	**9**	10
Investment and administrative expenses	**(13)**	(11)
	(4,152)	305
	(1,242)	3,565

11. ADMINISTRATION COSTS

	2003	2002
	(in millions of dollars)	
Pension and benefit delivery, accommodation and corporate services (Human Resources Development Canada)	**328**	279
Collection of contributions (Canada Customs and Revenue Agency)	**80**	78
Cheque issue and computer services (Public Works and Government Services Canada)	**13**	13
Actuarial services (Office of the Superintendent of Financial Institutions)	**1**	1
	422	371

Administration costs of the CPP represent the cost of services received from a number of federal government departments and an agency. Those costs are based on estimated allocations of costs and are charged to the CPP in accordance with the memoranda of understanding.

12. CONTINGENCIES

At March 31, 2003, there were 5,140 (8,185 in 2002) appeals relating to the payment of CPP pensions and benefits. Claims for these appeals could reach a maximum estimated amount of $22 million ($35 million in 2002). Any award made in favour of beneficiaries will be accounted for as an expenditure of the period in which the amount becomes payable.

13. LEGISLATIVE AMENDMENT

Legislation to amend the Canada Pension Plan and the *Canada Pension Plan Investment Board Act* was passed by Parliament on April 3, 2003, and is now subject to provincial approval. The provisions of the amending legislation contemplate a transfer of the CPP assets currently managed by the federal government to the CPP Investment Board. These assets consist of the bonds held by the CPP Investment Fund and the Deposit with Receiver General for Canada. If the legislative change is approved by the provinces, these assets will be transferred over a period of three years.

14. COMPARATIVE FIGURES

Certain comparative figures have been reclassified to conform to the current year's presentation.

ANNUAL REPORT OF THE

Canada Pension Plan

2002-2003

Canada Pension Plan

ANNUAL REPORT OF THE

Canada Pension Plan

2003-2004

Government of Canada Gouvernement du Canada

Canada

ANNUAL REPORT OF THE CANADA PENSION PLAN

Fiscal Year 2003-2004

ISPB 202-06-06E

Publication of the *2003-2004 Annual Report of the Canada Pension Plan* was delayed due to a number of organizational and governmental changes.

As of February 2006, the legal names of the minister and department responsible for the Canada Pension Plan (CPP) are the Minister of Human Resources and Skills Development and the Department of Human Resources and Skills Development respectively. Operationally, the department is known as Human Resources and Social Development Canada (HRSDC).

The names of the departments previously responsible for the CPP, namely Human Resources Development Canada (HRDC) and/or Social Development Canada (SDC), are used in this report in a historical context only.

Produced by the Department of Human Resources and Skills Development, in collaboration with: the Department of Finance, the Canada Revenue Agency, Public Works and Government Services Canada, and the Office of the Superintendent of Financial Institutions.

If you need additional copies of this report, it is available for printing at **www.hrsdc.gc.ca.**

Or you may contact:

HRSDC
Publications
Ottawa ON
K1A 0L1
Fax: (613) 948-9450

Aussi disponible en français sous le titre *Rapport annuel du Régime de pensions du Canada 2003-2004*.

To give feedback on the Annual Report, see our form online at **www.hrsdc.gc.ca** under "Publications".

For more detailed information about subjects covered in this report, or about the Canada Pension Plan in general, please visit **www.hrsdc.gc.ca.**

If you have questions, please call (free of charge from Canada and the U.S.):

1 800 277-9914 (English)
1 800 277-9915 (French)
1 800 255-4786 (TTY)

Cat. No SD15-2/2004E
ISBN 0-662-69376-0

Government of Canada Gouvernement du Canada

Her Excellency
The Governor General of Canada

May it please Your Excellency:

We have the pleasure of submitting the *Annual Report of the Canada Pension Plan* for the fiscal year 2003-2004.

Respectfully,

James M. Flaherty
Minister of Finance

Diane Finley
Minister of
Human Resources and Skills Development

Canada

Contents

This report on the Canada Pension Plan (CPP) consolidates input from all departments involved in the administration of the Plan: Social Development Canada (now Human Resources and Skills Development Canada), the Department of Finance, the Canada Revenue Agency (CRA), Public Works and Government Services Canada (PWGSC), and the Office of the Superintendent of Financial Institutions (OSFI).

2003-2004: The Year at a Glance

IN FISCAL 2003-2004:

- Following extensive consultations with the provinces, the Government of Canada proposed changes to both the disability benefit and the rules governing employer contributions in the 2004 Budget. The changes were included in the budget implementation bill, which was tabled in Parliament on March 23, 2004. [It received Royal Assent in May 2004. The CPP changes will come into force with the formal consent of two thirds of the provinces through an Order-in-Council process.]
- 3.8 million Canadians received benefits from the Canada Pension Plan, with a total value of approximately $22.6 billion.
- About 3.0 million people received $15.9 billion in CPP retirement pensions.
- About 928,000 surviving spouses or common-law partners and 86,000 children of deceased contributors received over $3.4 billion in CPP benefits.
- About 288,000 people with disabilities and 90,000 of their children received almost $3.1 billion in CPP disability benefits.
- 11.4 million people contributed to the CPP.
- 2.2 million people received Statements of Contributions.
- Changes to the *Canada Pension Plan Regulations* were implemented on January 1, 2004, to reflect the statutory increase in maximum pensionable earnings ($40,500 for 2004). The contribution rate remained unchanged at 9.9 percent.
- Administrative costs amounted to approximately $410 million, or 1.72 percent of the $22.6 billion in benefits paid. This compares favourably with administrative costs for other large pension plans and individual RRSPs.
- On March 31, 2004, total CPP assets were valued at approximately $72.5 billion and equalled about three years of benefits. The majority of the assets were held in provincial, territorial and federal government bonds, deposits with the Receiver General for Canada, domestic and foreign publicly traded equities, and private equity, real estate and infrastructure assets. Bonds, equities and real estate and infrastructure are stated at fair value.

The Canada Pension Plan in Brief

Almost everyone who participates in the paid labour force in Canada contributes to the Canada Pension Plan (CPP) or to its sister plan, the Quebec Pension Plan (QPP), and will at some time benefit from their provisions.

Established by an act of Parliament in 1965 and implemented in 1966, the CPP is a jointly managed federal-provincial plan. Quebec manages and administers its own Plan, the QPP, and participates in the decision making of the CPP. Benefits from either Plan are based on pension credits accumulated under both. The Plans are financed through mandatory contributions from employees, employers and self-employed people, as well as from investment income. (Information on the QPP is available from the Régie des rentes du Québec at **www.rrq.gouv.qc.ca**.)

While it is perhaps best known for its retirement pensions, the CPP also provides children's, survivor, disability and death benefits. The CPP administers the largest long-term disability insurance plan in Canada. Vocational rehabilitation services offered under the Plan help some disability beneficiaries regain their independence by helping them to return to the labour force, following a customized return-to-work plan.

Benefit calculations are based on how much and for how long a contributor has paid into the CPP, and in some cases, the age of the beneficiary. Benefits are not paid automatically—everyone must apply and provide proof of eligibility. Benefits are adjusted in January of each year as needed to reflect increases in the average cost of living, as measured by the Consumer Price Index.

Many Canadians live and work in other countries. Others move here after contributing to a public pension plan elsewhere. To help protect their pensions, Canada has entered into social security agreements with other nations. These agreements enable Canadians to receive public pensions from other countries and may help them receive Canadian benefits abroad. They also permit continuity of social security coverage when Canadians are temporarily working outside the country, eliminate duplicate contribution payments, and help them meet eligibility requirements for some CPP benefits and for other countries' public pensions.

Ensuring Financial Sustainability

As joint stewards of the CPP, the federal and provincial ministers of Finance review the Plan's financial state every three years and make recommendations as to whether benefits and/or contribution rates should be changed. They base their recommendations on a number of factors, including the results of an examination of the Plan by the Chief Actuary. The Chief Actuary is required under the legislation to produce an actuarial report on the CPP every three years (in the year before the legislated ministerial review of the Plan). The CPP legislation also requires the Chief Actuary to prepare an actuarial report any time a Bill is introduced in Parliament that, in the view of the Chief Actuary, has a material impact on the estimates in the most recent triennial actuarial report. This reporting ensures that the long-term financial implications of proposed Plan changes are given due consideration.

Changes to the CPP legislation governing the general level of benefits, the rate of contributions or the investment policy framework can be made only through an act of Parliament. All such changes require the agreement of at least two thirds of the participating provinces, representing at least two thirds of the population. The changes come into force only after two years' notice, unless all the provinces waive this requirement, and after Provincial Orders-in-Council confirming the changes have been passed. Quebec participates in decision-making regarding changes to the CPP legislation, even though it administers its own plan. It is important that Quebec be involved in changes to the CPP to ensure the portability of QPP and CPP benefits across Canada.

The legislation requires that federal and provincial ministers make best efforts to complete the next financial review of the Canada Pension Plan by the end of 2005. Ministers will base their review on a number of factors, including the conclusions of the *Twenty-first Actuarial Report* on the Canada Pension Plan, prepared by the Chief Actuary of the Canada Pension Plan for the purpose of the review. The previous triennial financial review of the Plan by ministers was in 2002. In the 2002 review, ministers concluded that the Plan was financially sustainable and agreed to make no changes to the Plan. Further information on this and previous reviews of the Plan can be found at **www.cpp-rpc.gc.ca**.

ACTUARIAL REPORTING

The *Twenty-first Actuarial Report* was tabled in Parliament by the Minister of Finance in December 2004. The report presented the financial status of the Plan as at December 31, 2003, and provided information to evaluate the Plan's financial sustainability over a long period, assuming Plan provisions remain unchanged. The findings of the report are an important element in the federal and provincial finance ministers' triennial financial review of the CPP slated for 2005. The last triennial financial review of the Plan by ministers was based on the findings of the *Eighteenth Actuarial Report* (as at December 31, 2000). Since this report, the Canada Pension Plan was subject to a series of amendments, the financial implications were outlined in the *Nineteenth* and *Twentieth Actuarial Reports*.

Canadians can have confidence in the results of the *Twenty-first Actuarial Report* and the conclusions reached by the Chief Actuary about the long-term financial health of the Plan. A panel of independent Canadian actuaries, selected through an arm's-length process, will review the report.

Federal and provincial finance ministers have endorsed regular peer reviews of triennial actuarial reports. The Office of the Chief Actuary has meticulously followed this recommendation. Panel reports and recommendations, as well as actuarial reports, can be found at **www.osfi.gc.ca**.

A FAIR APPROACH TO FUNDING

When it was introduced in 1966, the CPP was designed as a pay-as-you-go plan, with a small reserve. This meant that the benefits for one generation would be paid largely from the contributions of later generations. This approach made sense under the economic, financial and demographic circumstances of the time. The period was characterized by a rapid growth in wages and labour-force participation, and low rates of return on investments.

The pay-as-you-go approach also allowed the federal and provincial governments to keep contributions at a reasonable level while beginning to pay full retirement benefits as early as the mid-1970s. This was important—many of the seniors who received benefits at that time had been unable to accumulate sufficient retirement savings.

However, demographic and economic developments and changes to benefits in the 30 years that followed resulted in significantly higher costs. When federal and provincial finance ministers began their five-year statutory review of the CPP finances in 1996, contribution rates, already legislated to rise to 10.1 percent by 2016, were expected to have to rise again—to 14.2 percent by 2030—to continue to finance the Plan on a pay-as-you-go basis.

Continuing to finance the Plan on a pay-as-you-go basis would have meant imposing a heavy financial burden on Canadians in the workforce 25 years down the road, which was deemed unacceptable by the federal and provincial governments. Therefore, in 1997, they agreed instead to change the funding approach of the Plan to a hybrid of pay-as-you-go and full funding. Under full funding, each generation pays for its own benefits.

Steady-state financing

To reduce the burden on future generations, the federal and provincial governments introduced "steady-state" financing as part of the 1997 reform agreement. This approach requires that contribution rates be set no lower than the lowest rate expected to ensure the long-term financial stability of the Plan without recourse to further rate increases. At the time of the reforms, this was determined to be 9.9 percent. Therefore, under steady-state financing, the contribution rate was scheduled to increase incrementally (from 5.6 percent in 1996) to 9.9 percent in 2003, and to remain at this level thereafter.

According to the Chief Actuary of Canada, steady-state financing will generate a level of contributions that exceeds the benefits paid until 2021. Funds not immediately required to pay benefits will be transferred to the CPP Investment Board for investment.

Plan assets will accumulate rapidly over this period and over time will help pay the growing costs that are expected as more and more "baby boomers" begin to collect their retirement pension.

After 2021, when most of the baby boomers have retired, and benefits paid begin to exceed contributions, investment revenues from the CPP's accumulated assets will provide the funds necessary to make up the difference. However, contributions will remain the main source of funding for benefits.

The steady-state financing approach has moved the CPP away from pay-as-you-go financing (with a small reserve) towards fuller funding. By 2025, the Plan is expected to be about 25 percent pre-funded (i.e., Plan assets cover about 25 percent of benefits in pay and earned to that date). The move to steady-state financing has improved fairness across generations. Moving to full-funding would have contributors during the transition paying much higher contributions—they would have had to pay for the benefits of current retirees and for the development of a reserve to cover their own pensions. Continuing with a pay-as-you-go approach would also have been unfair, as it would have meant a sharp increase in the contribution rate over the coming decades.

According to the *Twenty-first Actuarial Report*, as at December 31, 2003, the Plan is 12 percent funded. The relative size of the unfunded liability ($516.3 billion at the end of 2003) will decline over time as Plan assets grow more rapidly than Plan liabilities over the next few decades and at least as quickly thereafter. As a result, by 2025, Plan assets will cover about 25 percent of the Plan's actuarial liabilities. According to the Chief Actuary, the evolution of the funding level and the projected growth rates of assets and liabilities are better measures of the future financial health of the CPP than is the notion of the unfunded liability at a particular point in time.

A partially funded CPP not only balances the two approaches to funding, but also contributes to diversifying the funding of Canada's retirement income system:

- the Old Age Security program, funded by federal government revenues, and
- private savings, including tax-deferred, fully funded employer-sponsored pension plans and registered retirement savings plans (RRSPs).

A diversified funding approach allows Canada's retirement income system to be less vulnerable to changes in economic and demographic conditions than are systems in countries that use a single funding approach. In addition, the Canadian approach to pension provision, based on a mix of public and private pensions, is an effective way to provide for retirement income needs, according to international organizations.

2004 Budget Changes to the CPP

Following extensive consultations with provincial finance ministers, the Government of Canada's 2004 Budget proposed a number of changes to the CPP, including some to the disability benefit and to the Plan's contribution requirements. The changes to the disability benefit are intended to encourage more clients who believe that they may be able to work to try to return to regular employment. The changes to contribution requirements are intended to reduce the compliance burden on employers.

The proposed changes were included in the budget implementation bill that was tabled in Parliament on March 23, 2004.

Financial Accountability

Since 1999-2000, the CPP has used the accrual basis of accounting for revenues and expenditures. This method gives administrators a detailed financial picture and allows accurate matching of revenue and expenditures in the year in which they occur.

As at March 31, 2004, total CPP assets were valued at approximately $72.5 billion. Net plan assets are contributions and investment income that have accumulated since the Plan's inception in 1966—less benefit and administrative expenditures over the same period. According to the Chief Actuary, Plan assets are expected to increase appreciably over the next decades.

CPP ACCOUNT

A separate account, the CPP Account, has been established in the accounts of the Government of Canada to record the financial elements of the Plan: contributions, interest, pensions and other benefits paid, and administrative expenditures. The CPP Account also records the amounts transferred to or received from both the CPP Investment Fund and the CPP Investment Board. Spending authority is limited to the Plan's net assets. The CPP assets are not part of the federal government's revenues and expenditures.

Prior to the coming into force of Bill C-3 (*An Act to Amend the Canada Pension Plan and the Canada Pension Plan Investment Board Act*), the Canada Pension Plan Investment Board was responsible for investing net new funds, while the CPP Account's operating balance and bond portfolio were managed by the Government of Canada. The amended legislation provides for the transfer of CPP assets that were previously administered by the federal government to the CPP Investment Board, beginning in 2004. These assets consist of the bonds held by the CPP Investment Fund and a portion of the deposit with the Receiver General for Canada. The CPP Investment Board and the federal government have signed an agreement governing the transfer of the assets.

The bonds will be transferred to the Board over a three-year period beginning in May 2004. Funds on deposit with the Receiver General for Canada will be transferred over a period of 12 months beginning in September 2004.

CPP INVESTMENT BOARD

The CPP Investment Board was created by an Act of Parliament in December 1997 to invest funds not required by the Canada Pension Plan to pay current benefits.

The Board is independent of the CPP. It operates at arm's length from government and is overseen by an independent board of directors. Its legislated mandate is to manage funds transferred from the CPP "in the best interests of the contributors and beneficiaries of the Plan." The Board is to invest CPP assets "with a view to achieving a maximum rate of return, without undue risk of loss." It must also consider the factors that affect the Plan's funding and its ability to meet its financial obligations.

The CPP Investment Board has a long-term investment horizon. In his most recent report, the Chief Actuary of Canada estimates that contribution revenues will exceed CPP benefit payments and expenses well into the future, and that the CPP will not need money from investment income until 2022.

Further information on the Board's mandate, governance structure and investment policy can be found at **www.cppib.ca**.

CPP Assets

As at March 31, 2004, CPP assets consisted of $39.7 billion in fixed-income securities, cash and other assets, and $32.8 billion in publicly traded stocks, private equities, real estate and infrastructure assets.

The CPP reserve fund earned $10.3 billion for a return of 17.6 percent for the fiscal year ending March 31, 2004.

Investing for our future

The CPP Investment Board believes that publicly traded equities will outperform fixed income assets over the long term. Consequently, the Board will continue to invest in publicly traded equities or stocks so that CPP assets are allocated in a way that reflects the long-term funding requirements of the Plan.

To complement its $30.1 billion passive public equity portfolio, the CPP Investment Board has expanded into private equities through externally managed funds that provide venture capital and expansion financing to private companies. These investments are made through limited partnerships or pooled funds managed by investment firms in Canada and around the world.

As at March 31, 2004, private equity commitments by the CPP Investment Board were approximately $6 billion, of which $2 billion had been invested. These commitments covered 42 limited partnerships managed by 36 general partners, representing investments in more than 2,500 underlying companies.

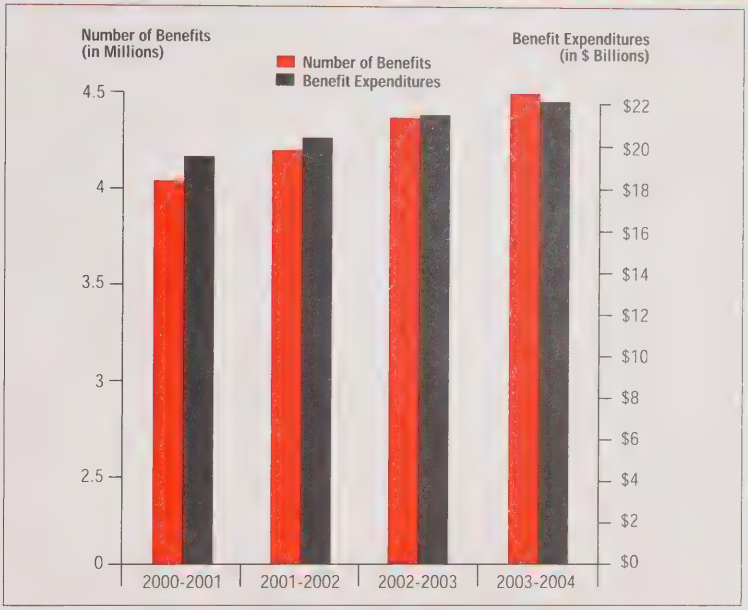
Like other major pension funds, the CPP Investment Board is looking for opportunities to increase investments in real return assets, such as real estate and infrastructure, because their value over time will likely track and surpass the general rate of inflation.

In compliance with its statutory requirement to hold a public meeting in each participating province at least once every two years, the Board held public meetings in the provincial capitals in January 2001 and June 2002. The next meetings are planned for September-October 2004.

Benefits and Expenditures

The number of people receiving CPP benefits has increased steadily over the past decade. As a result, Plan expenditures have increased. Figure 1 shows the yearly increases since 2000-2001. Figure 2 (page 11) shows the percentage of CPP expenditures by type of benefit.

Figure 1 – BENEFITS AND EXPENDITURES BY FISCAL YEAR



RETIREMENT PENSIONS

Retirement pensions represent 66 percent of the total number of CPP benefits paid and 70 percent of the total benefit dollars paid out by the CPP in 2003-04. The amount of each contributor's pension depends on how much and how long he or she has contributed and at what age he or she begins to draw the benefits. In March 2004, the monthly maximum retirement pension was $814.17; the average payment was $457.66.

The CPP offers flexibility with respect to the age of retirement. Seniors can take their pension as early as the age of 60 or receive a larger pension if they wait until after they turn 65 to begin receiving it. The CPP permanently reduces the pension by 0.5 percent per month for those who take their pension before their 65th birthday, reflecting the fact that these seniors will, on average, receive their benefits longer than someone who retires at the age of 65. For those who take their pension after their 65th birthday, the CPP permanently increases the pension by 0.5 percent

per month (up to a maximum of 30 percent), reflecting the fact that these seniors will receive their benefits for a shorter amount of time on average. The adjustments are intended to ensure that there is no advantage or disadvantage from taking the retirement benefit at a particular age. The Chief Actuary of the Canada Pension Plan completed a study on this issue in March 2003. It found that, given current Plan provisions, the adjustments for early/late pension take-up create an incentive to take the benefit early. Removing this incentive would require the downward adjustment of early pensions and upward adjustment of late pensions. The study also noted that the neutrality of the Plan's adjustment factors would be improved by changing the benefit calculation and contribution requirements.

The study is available at **www.osfi.gc.ca**.

DISABILITY BENEFITS

Disability benefits, paid to eligible contributors and their children, represent 8 percent of the total number of CPP benefits paid and 14 percent of the total benefit dollars paid out by the CPP in 2003-04. In March 2004, the maximum monthly disability benefit was \$992.80; the average payment was \$747.04. The children's monthly benefit was a flat rate of \$192.68.

The 2004 Budget Implementation Bill included amendments to the CPP to allow for reinstatement of a CPP disability benefit that had been stopped because a person had returned to work if the person again became incapable of working within two years after the stopping of the benefit.

The planned implementation date for the new automatic reinstatement protection is early 2005.

SURVIVOR BENEFITS

Survivor benefits, paid to the surviving spouse or common-law partner of the contributor and his/her dependent children, represent 23 percent of the total number of CPP benefits paid and 15 percent of the total benefit dollars paid out by the CPP in 2003-04. The amount of the monthly survivor benefit varies depending on a number of factors, including the age of the spouse or common-law partner at death and whether the beneficiary also receives other CPP benefits.

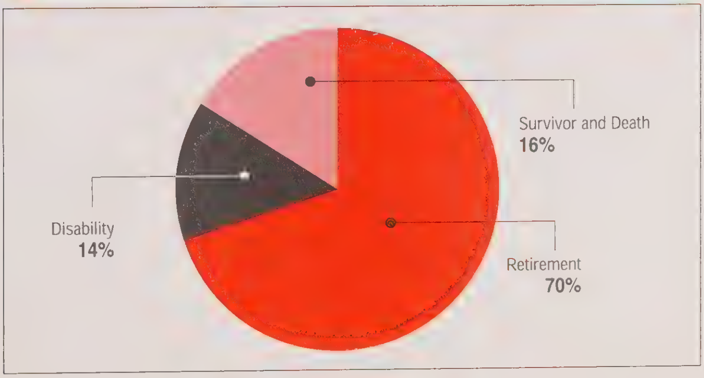
DEATH BENEFITS

Death benefits represent 3 percent of the total number of CPP benefits paid and 1 percent of the total benefit dollars paid out by the CPP in 2003-04. The death benefit is a one-time payment. The maximum payable is $2,500; the average payment in March 2004 was $2,214.10.

OTHER PROVISIONS

The CPP includes provisions that compensate for periods of low earnings, namely the child rearing provision (CRP) and the 15 percent general drop-out provision. The CRP allows the CPP to drop up to seven years of low or zero earnings (while caring for a child under the age of seven) from the calculation of a contributor's CPP disability, survivor and/or retirement benefit. The 15 percent general drop-out provision is for low or zero earning years and applies to all contributors. The Plan has other provisions under which married or common-law spouses may either share their retirement pensions (where the union is intact) or split their credits (where the union has dissolved).

Figure 2 – PERCENTAGE OF BENEFIT DOLLARS PAID FOR 2003-2004



Improved Service Delivery

REACHING OUT TO CANADIANS

During 2003-04, Social Development Canada continued its efforts to help Canadians better understand public pensions and the retirement income system, and to encourage them to actively plan and prepare for their own retirement. Information on the CPP is available in print, on the Internet, in person at local offices, by phone, and at electronic kiosks in government offices and public buildings.

Personalized contact with clients continued to receive high priority. In 2003-04, SDC issued personal CPP Statements of Contributions to more than 2.2 million contributors between the ages of 18 and 70. The statements were accompanied by information on the retirement income system in Canada.

DELIVERING SERVICE

In 2003-2004, SDC continued to modernize CPP program delivery. With the multi-year Information Technology Renewal project, staff now have access to a consolidated view of complete CPP and OAS client and benefit information, benefit payment history and lifetime CPP contributions. In addition, fully automated adjudication (determination of eligibility and calculations of entitlement) has been introduced for CPP retirement benefits. Capabilities for automated adjudication of additional benefits will continue over the next several years. At the same time, the Department continues to focus on maintaining the existing CPP information technology systems.

PROCESSING BENEFITS

CPP services are offered in person, by telephone, online and by mail. In 2003-04, staff received 60,514 disability applications. Decisions on 82 percent of all CPP disability applications, which are complex and require medical information, were made within 120 calendar days of receipt of the completed application. Improved communication with clients and their physicians helped staff make well-informed decisions and helped CPP disability applicants better understand the reasons for decisions. As a result, close to 81.6 percent of the applications for disability benefits in 2003-04 were finalized in the initial stages. Retirement pension applications, which make up the bulk of the CPP applications, and which are less complex, were processed within an average of 22 days (see Table 1 below).

TABLE 1 – SPEED OF PROCESSING NEW APPLICATIONS

National speed-of-service measures	Objective	2003-04 National Average
Number of working days to process initial CPP applications* (excluding disability applications)	28	22
Number of working days to process initial disability applications	70	82

*Number of days between the date the application is received and the date of the decision.

TABLE 2 – TELEPHONE SERVICE STATISTICS*

	2002-03	2003-04
Percentage of clients served by a service agent within 180 seconds of placing a call**	96.3%	99%
Average waiting time to speak with a service agent	20 sec.	16 sec.
Average time clients spend talking to a service agent	237 sec.	229 sec.

* Table includes CPP and Old Age Security totals. Speed of service does not vary between programs.
** The objective is to serve clients within 180 seconds for 95 percent of calls.

SDC call centres received over 2 million calls about the CPP in 2003-04. Positive responses to the mail-out of personalized statements to CPP contributors and inquiries during the traditionally busy T4 period contributed to the high number of calls.

Despite higher call volumes, service to clients continues to improve. In 2003-04, enhanced call management allowed for improved telephone service. Results show in the reduction of client waiting time and a significant increase in the speed of service (see Table 2 above).

Managing the CPP

COLLECTING AND RECORDING CONTRIBUTIONS

Contributions to the CPP are paid on earnings between a minimum and a maximum amount. The minimum (which remains constant) is $3,500 and the maximum is adjusted annually to reflect the growth in the average Canadian industrial wage. The maximum amount of pensionable earnings as of January 1, 2004, was $40,500 (up from $39,900 in 2003). Contributions stop once a contributor reaches the age of 70 or begins to receive a CPP retirement pension or disability benefit.

The contribution rates for 2004 are 4.95 percent for employees and 4.95 percent for employers. People who are self-employed pay both portions, for a total of 9.9 percent. Employers and employees make approximately 94 percent of contributions; the remaining 6 percent comes from the self-employed.

All CPP contributions are remitted to the Canada Revenue Agency (CRA). In 2003-04, contributions amounted to $28 billion.

CRA also assesses and verifies earnings and contributions, advises employers and employees of their rights and responsibilities, conducts audits, and reconciles reports and T4 slips. To verify that contribution requirements are being met, CRA applies a compliance and enforcement process that can vary from a computerized data match to an on-site audit. There are approximately 1.5 million existing employer accounts. During 2003-04, CRA conducted 62,905 audits, concentrating on files with irregularities.

OVERPAYMENT OF BENEFITS

Consistent with its mandate to manage the CPP effectively, the Department has procedures in place to detect benefit overpayments. During 2003-04, overpayments totalling $45 million were detected. Of this amount, $37 million was recovered and remission was granted of debts totalling $4 million. The remaining $4 million was in the process of being collected at the end of the 2003-04 fiscal year and is included in the CPP's accounts receivable.

CHANGES ANNOUNCED IN THE 2004 BUDGET

In 2004, the rules governing contributions to the Canada Pension Plan were amended. They now allow a new employer who immediately succeeds another as a result of a change in business structure to take into account the contributions the predecessor employer made for that same employee when determining amounts due. This change was extended to situations where self-employed individuals become employees of a corporation controlled by them or vice versa. The new rules apply for every year after 2003.

Before this change, when a business was restructured—notably as a result of a winding up and immediate reconstitution under a different legal structure (e.g., where a limited partnership is reconstituted as a corporation) or the acquisition of a major portion of the employer's property or of a distinct part of the employer's business (e.g., a distinct division of a business is sold to another enterprise)—employees were treated as if they had new employers. Employers were required to begin withholding CPP contributions anew and they could not take into account the contributions withheld at source by the previous employer—even if there had been no interruption of service by the employee.

Other amendments clarify the annual employers' contributions amount required under the Act and specify that only amounts remitted in excess may be refunded to the employer.

These changes will ensure harmonization of contribution requirements between the Canada Pension Plan and the Quebec Pension Plan. Further information about these changes can be obtained by contacting the Canada Revenue Agency at 1 800 959-5525.

ADMINISTRATIVE COSTS

In 2003-04, it cost approximately $410 million to administer the CPP, with Human Resources Development Canada (now SDC) accounting for the largest portion—$309 million (see Table 3 below). CRA required approximately $85 million and Public Works and Government Services Canada (PWGSC) $15 million, for services to the CPP. The Office of the Superintendent of Financial Institutions (OSFI), where the Office of the Chief Actuary is housed, and the Department of Finance incurred costs of about $1 million and $425,000, respectively.

Since the administrative costs of the CPP Investment Board are drawn from the Board's investment income, they are reported in that organization's annual report. This is consistent with the arm's-length administration of the Board. In 2003-04, the CPP Investment Board reported $24 million in operating expenses and external investment management fees.

CPP administrative expenses in 2003-04 represent 1.72 percent of the $22.6 billion in benefits paid. This ratio compares very favourably with that of other pension plans. CPP administrative costs also compare favourably with those of RRSPs.

Table 3 presents the CPP's administrative expenditures for the last three years.

TABLE 3 – CPP ADMINISTRATIVE COSTS 2001-02 TO 2003-04

	Expenditures (in $ thousands)		
Department/Agency	**2001-02**	**2002-03**	**2003-04**
Social Development Canada (formerly HRDC)	$279,159	$327,964	$308,923
Canada Revenue Agency	77,618	80,229	85,258
Public Works and Government Services Canada	12,440	12,823	14,693
Office of the Superintendent of Financial Institutions	1,364	690	1,038
Finance Canada	492	495	425
Total	$371,073	$422,201	$410,337

THE APPEALS PROCESS

There are three opportunities for review of a person's CPP benefit application (as shown on page 16). Most requests for review concern an application for disability benefits.

The first opportunity involves a request to the Minister of Human Resources and Skills Development (see note on the inside cover of this report) for a reconsideration (or administrative review) of a decision concerning a benefit or a division of pension credits. The number of requests for reconsideration in disability cases declined from 12,401 in 2002-03 to 10,207 in 2003-04, a decrease of about 18 percent.

The number of benefits awarded at reconsideration remained relatively unchanged from 2002-03 to 2003-04, increasing from 27 percent to 28 percent.

A person who is not satisfied with the decision made at the departmental reconsideration level can appeal to a Review Tribunal. A Review Tribunal is an independent body made up of three people chosen by the Commissioner of Review Tribunals from a panel of 100 to 400 part-time members appointed by the Governor-in-Council. In 2003-04, the Office of the Commissioner of Review Tribunals (OCRT) received 4,744 appeals under the CPP. In the same period, the OCRT issued 4,503 decisions, of which 2,312 (51.3 percent of the total) had been decided in favour of the appellant. In addition, another 853 cases were concluded as a result of settlements offered by Social Development Canada.

The final opportunity for review is the Pension Appeals Board (PAB)—a tribunal operating at arm's length from SDC. Board members are judges or former judges of the federal court or a superior court of a province. Hearings are not automatic at this level; claimants or the Minister must request "leave to appeal". Ninety-five percent of the 1,183 applications for leave received in 2003-04 concerned CPP disability benefits. Of the total number of applications for leave received, 84 percent were granted. With respect to final decisions, 53 percent were in favour of the claimant.

The Department continues to work with the Office of the Commissioner of Review Tribunals and the Pension Appeals Board to improve coordination and response times and to identify opportunities for the earliest possible resolution of appeals.

THE APPEALS PROCESS

INITIAL DECISION

Social Development Canada (SDC) issues a decision on CPP benefit eligibility.

If the client is not satisfied with the decision, he or she can submit a request for reconsideration to the Minister of Social Development.

FIRST LEVEL OF REVIEW

Review of client file and decision issued by SDC

If the client is not satisfied with the decision, he or she has 90 days to appeal to the Office of the Commissioner of Review Tribunals.

SECOND LEVEL OF REVIEW

Appeal to the Office of the Commissioner of Review Tribunals

The case is heard and a decision is issued.

If either the client or SDC is not satisfied with the decision, an application for "Leave to Appeal" may be submitted to the Pension Appeals Board.

THIRD LEVEL OF REVIEW

Appeal to the Pension Appeals Board

If leave is granted, the case is heard and a decision is issued.

The decision of the Pension Appeals Board is final, subject to judicial review by the Federal Court of Canada.

Looking to the Future

Some 300,000 new CPP applications are received each year and a significant increase is expected as our population ages. The challenge will be to improve service delivery to ensure that Canadians continue to receive timely, accurate and client-focused service. Long-term initiatives aimed at meeting that challenge are now underway.

CPP ONLINE

CPP Online supports the objectives of the federal Government On-Line (GOL) initiative and the commitment to provide Canadians with full electronic access to key federal information and services by 2005. CPP Online initiatives include the implementation of a web-based system that allows a wider range of inquiries and client transactions online and provides more integrated information on related benefits. The importance of strengthening our technological infrastructure is clear, especially since the fastest-growing group of Internet users is the senior population.

The Department made it a priority to update the systems that help deliver benefits. Evolving over the next four years, the systems will support better decision making by improving the information available to management, clients and staff through faster and more up-to-date technology. The improvements will further reduce the paper burden and the complexity of the application process.

Putting CPP information online is a multi-year project designed to provide Canadians with online access to information, data, and services essential to income security and retirement planning. A comprehensive review of legislation, regulations, policies, and procedures will lay the groundwork for an innovative, leading-edge approach to online services and their policy and program context.

ONLINE SERVICES

By 2007, the Department will offer, in a secure environment, a number of online service options to allow access to information and services that are essential to income security and retirement. These services will include:

View and update personal information
In 2005, CPP clients will have secure online access to their personal information. Using this service, they will be able to view and update their mailing address and direct-deposit information, and view their monthly payment amount. Enhancements will continue to be made, allowing more information to be viewed and updated in coming years.

Streamlined and automated CPP Statement of Contributions
CPP contributors can now submit an online request to receive a copy of their Statement of Contributions by mail. In 2005, they will be able to view Statement of Contributions information online.

Tax information slips online
Since 2004, CPP clients have been able to view their CPP T4 slips online, starting with those for the 2003 taxation year. They also have the option to choose to use the online service to access their T4 slips in the future instead of having them sent by mail.

SIMPLIFYING THE APPLICATION PROCESS

Simplifying the application process for the CPP retirement pension is part of the Department 's planned service delivery improvements. The goal is to make the application process easier for clients through streamlined, client-driven and more effective services.

Making it easier to apply for the CPP retirement pension will be the first step in building a modern service system that is based on Canadians' needs and expectations. It will allow the use of alternative sources for proof of date of birth. As part of this initiative, services are being introduced that allow clients to apply for benefits online.

Since July 2003, a simplified CPP retirement application has been available for clients to fill out online. In March 2004, simplified OAS applications were also made available online. While clients could fill out these forms on the computer, they had to be printed, signed and mailed to SDC along with proof of birth. In 2005, SDC will remove the requirement for the majority of clients to provide documentary proof of birth when the client's age and identity can be validated with the Social Insurance Register electronically.

In March 2004, SDC launched its first benefit application form that can be submitted over the Internet. Clients are now able to fill out a CPP retirement pension application online and submit it electronically. To complete the application process, clients must print, sign and mail the Signature Page along with their proof of birth. When client authentication enhancements are completed, clients will be able to sign their applications electronically.

REACHING ALL CANADIANS

Public pension programs help millions of people in Canada every day. The Department's primary objective is that every Canadian receive the benefits to which he or she is entitled under its programs.

There has been a dramatic decline in the low-income rate among Canadian seniors in recent decades. This is due in large part to the existence of public pensions such as the CPP.

Over the past several years, the Department has made a concerted effort to tell Canadians what they can expect from their public pensions and how they should prepare for their own retirement. Striving to communicate as directly as possible, the CPP will continue improving and personalizing its programs to reach its clients.

The Internet has a tremendous ability to reach Canadians. Social Development Canada has led the development of a cross-departmental website called Canada Benefits (**www.canadabenefits.gc.ca**). The site's mandate is to provide central access to government-wide benefit programs and services for individuals.

The Canada Benefits site provides access to federal, provincial and territorial programs and services. These include, among others, public pensions, employment insurance benefits, and housing grants. The award-winning website supports the "citizen-first" principle—where information is organized according to the needs of Canadians and not the structures of government. For example, an interactive tool called the "Benefits Finder" provides citizens with a listing of programs and services relevant to their circumstances.

Since its update in January 2003, the Canada Benefits site has experienced significant success, receiving an average of 2,000 visitors every day. Through the Canada Benefits site and other means of communication, SDC was able to reach more Canadians than ever. Based on the firm conviction that all Canadians deserve financial security, the Department strives to make them aware of the benefits available and helps them obtain those to which they are entitled.

Canada Pension Plan

Financial Statements

for the year ended March 31, 2004

Management's responsibility for financial statements

The financial statements of the Canada Pension Plan have been prepared by management of Social Development Canada in accordance with the Canadian generally accepted accounting principles.

Management is responsible for the integrity and objectivity of the data in these financial statements, including the amounts which must, of necessity, be based on best estimates and judgements. The financial information presented throughout the Annual Report is consistent with the financial statements.

In support of its responsibilities, management has developed and maintains systems of internal control and supporting procedures. They are designed to provide reasonable assurance that assets are safeguarded, recorded and properly maintained and transactions are properly authorized and are in accordance with the *Canada Pension Plan* and *Financial Administration Act* and accompanying regulations. These controls include the establishment of an organizational structure that provides a well defined division of responsibilities and accountability, the selection and training of qualified staff, and the communication of policies and guidelines throughout the organization. Internal controls are reviewed and evaluated by both internal and external auditors in accordance with its respective audits. Management also reviews the recommendations of its internal and external auditors for improvements in internal controls.

The Auditor General of Canada, the external auditor of the Canada Pension Plan, has conducted an independent audit of the financial statements in accordance with Canadian generally accepted auditing standards and has reported to the Minister of Social Development.

Janet Milne
Assistant Deputy Minister
Financial and Administrative Services

Nicole Jauvin
Deputy Minister
Social Development Canada

September 2, 2004

Auditor General of Canada
Vérificatrice générale du Canada

AUDITOR'S REPORT

To the Minister of Social Development

I have audited the statement of net assets of the Canada Pension Plan as at March 31, 2004 and the statements of changes in net assets and cash flow for the year then ended. These financial statements are the responsibility of the management of Social Development Canada. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audit in accordance with Canadian generally accepted auditing standards. Those standards require that I plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In my opinion, these financial statements present fairly, in all material respects, the financial position of the Canada Pension Plan as at March 31, 2004 and the changes in its net assets and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

Sheila Fraser

Sheila Fraser, FCA
Auditor General of Canada

Ottawa, Canada
September 2, 2004

Statement of Net Assets
as at March 31

	2004	2003
		Restated (Note 3)
		(in millions of dollars)
Assets		
Investments		
CPP Investment Fund – at fair value (Note 4)		
Provincial and Territorial bonds	**25,397**	26,080
Canada bonds	**4,070**	4,071
CPP Investment Board – at fair value (Note 5)	**32,894**	17,453
Cash		
Deposit with Receiver General for Canada	**7,483**	7,093
Receivables		
Contributions	**1,946**	1,631
Accrued interest	**862**	939
Régime des rentes du Québec	**28**	66
Beneficiaries (Note 6)	**36**	49
	72,716	57,382
Liabilities		
Accounts payable	**55**	74
Accrued pensions and benefits	**51**	55
CPP Investment Board's Liabilities, net of its other assets	**99**	2
	205	131
Net Assets	**72,511**	57,251
Net Assets, represented by:		
Canada Pension Plan Investment Fund	**29,467**	30,151
Accumulated transfers to Canada Pension Plan Investment Board	**29,824**	21,690
Accumulated net gain (loss) from Investment Board's operations	**2,971**	(4,239)
Canada Pension Plan Account (Note 7)	**7,483**	7,093
CPP receivables, net of liabilities	**2,766**	2,556
Net Assets	**72,511**	57,251

The accompanying notes are an integral part of these financial statements.

Approved by Social Development Canada:

Janet Milne
Assistant Deputy Minister
Financial and Administrative Services

Nicole Jauvin
Deputy Minister
Social Development Canada

Statement of Changes in Net Assets
for the year ended March 31

	2004	2003
		Restated (Note 3)
	(in millions of dollars)	
Net assets, beginning of year	57,251	55,094
Increase in assets		
Contributions (Note 8)	**28,029**	25,203
Investment Income / (loss) (Note 9)	**10,248**	(1,049)
	38,277	24,154
Decrease in assets		
Pensions and Benefits		
Retirement	**15,880**	15,071
Survivors	**3,194**	3,071
Disability	**2,850**	2,779
Disabled Contributor's Child	**257**	251
Death	**255**	234
Orphan	**213**	210
Net overpayments	**(42)**	(41)
	22,607	21,575
Administration costs (Note 10)	**410**	422
	23,017	21,997
Increase in net assets	**15,260**	2,157
Net assets, end of year	72,511	57,251

The accompanying notes are an integral part of these financial statements.

Statement of Cash Flow
for the year ended March 31

	2004	2003
	(in millions of dollars)	
Cash Flow Provided by Operating Activities		
Cash Receipts:		
Contributions	**27,714**	24,950
Interest from CPP Investment Fund	**2,572**	2,839
Interest on Deposit with Receiver General for Canada	**188**	163
Recoveries from Régime des rentes du Québec	**288**	192
Recoveries from beneficiaries	**37**	37
	30,799	28,181
Cash Payments:		
Pensions and Benefits	**(22,634)**	(21,613)
Repayments to Régime des rentes du Québec	**(251)**	(235)
Administration costs	**(430)**	(395)
	(23,315)	(22,243)
	7,484	5,938
Cash Flow Used In Investing Activities		
Transfers to CPP Investment Board	**(8,134)**	(7,318)
Disposals of bonds – CPP Investment Fund	**2,498**	2,383
Reinvestments in bonds – CPP Investment Fund	**(1,458)**	(680)
	(7,094)	(5,615)
Net increase in the Deposit with Receiver General for Canada	**390**	323
Deposit with Receiver General for Canada, beginning of year	**7,093**	6,770
Deposit with Receiver General for Canada, end of year	**7,483**	7,093

The accompanying notes are an integral part of these financial statements.

Notes to financial statements March 31, 2004

1. DESCRIPTION OF THE CANADA PENSION PLAN

a) Description of the CPP

The Canada Pension Plan (CPP) is a federal/provincial plan established by an Act of Parliament in 1965.

The CPP began operations in 1966. It is a compulsory and contributory social insurance program operating in all parts of Canada, except Quebec, which operates the Régime des rentes du Québec, a comparable program. The Plan's objective is to provide a measure of protection to workers and their families against the loss of earnings due to retirement, disability or death.

The Minister of Social Development is responsible for the administration of the *Canada Pension Plan* (the CPP Act); the Minister of National Revenue is responsible for collecting contributions. The Minister of Finance and his provincial counterparts are responsible for setting CPP contribution rates, pension and benefit levels and funding policy.

The financial activities of the Canada Pension Plan are recorded in the CPP Account (Note 7). The CPP Investment Fund (Note 4) holds the bond portfolio of the Plan, and the Plan's investments in capital markets are managed by the CPP Investment Board (Note 5). The financial transactions affecting the Account and the Investment Fund are governed by the CPP Act and regulations. The Investment Board's transactions are governed by the *Canada Pension Plan Investment Board Act* and the accompanying regulations.

As stated in the CPP Act, changes to this Act require the approval of at least two-thirds of the provinces having, in the aggregate, not less than two-thirds of the population of all included provinces.

b) Financing

CPP is financed by contributions and investment returns. Employers and employees pay contributions equally to CPP. Self-employed workers pay the full amount.

CPP was designed initially to be financed on a pay-as-you-go basis, which means that the Plan would operate on a current basis with pensions and benefits being paid out of current contributions. With changes made to the Act in 1997, CPP is now intended to be funded on a "steady-state" basis—that is, combined contributions increased to 9.9% of pensionable earnings in 2003 and have leveled off since.

From 1966 to 1986, the combined employer-employee contribution rate remained at 3.6% of pensionable earnings. In 1987, it was raised to 3.8% and increased yearly by 0.2% to reach 5.6% in 1996. In the years 1997 to 2002, the combined contribution rate was increased annually to reach 9.9% in 2003. The maximum combined contribution for 2004 was $3,663 (2003 – $3,604).

The CPP Act provides that an actuarial report shall be prepared every three years for purposes of the review of the financial state of the CPP by the Minister of Finance and his provincial counterparts. The Eighteenth Actuarial Report of the Chief Actuary of the Office of the Superintendent of Financial Institutions done as at December 31, 2000 was presented to the Minister of Finance in December 2001, then tabled in the House of Commons on December 10, 2001. Based on this report, federal and provincial ministers of Finance concluded at the end of the 2002 Triennial Review process that the CPP is financially sound and that the 9.9% combined employee-employer contribution rate reached in 2003 is expected to be sufficient to substain the Plan in the face of an aging population. A number of assumptions such as long term rate of return on assets, inflation rate, mortality rates, increase in salary and benefit rates, among other things, were used in the 18th CPP actuarial report. These assumptions reflect best estimates of future economic and demographic events. The next actuarial report as at December 31, 2003 is expected to be completed by December 2004.

c) Net assets of the Plan

The net assets of the Plan are composed of the deposit with the Receiver General for Canada, short term investments, long term investments in bonds held by the CPP Investment Fund and investments managed by the CPP Investment Board. The net assets represent funds accumulated for the payment of pensions, benefits and administration costs. This amount does not cover the actuarial present value of accrued pensions and benefits. As at March 31, 2004, the net assets of the Plan are of $72.5 billion (2003 – $57.3 billion). This amount represents approximately 3.2 times the total of pensions and benefits for the year 2003-2004.

d) Pensions and benefits

Retirement pensions – A retirement pension is payable to each contributor at age 60 or older, according to the provisions of the Act. The monthly amount is equal to 25% of the contributor's average monthly pensionable earnings during the pensionable period. The amount may be reduced or increased depending upon whether the contributor applies for a retirement pension before or after age 65. This adjustment cannot exceed 30%. The maximum new monthly pension payable at age 65 in 2004 is $814.17 (2003 – $801.25).

Disability benefits – A disability benefit is payable to a contributor who is disabled, according to the provisions of the Act. The amount of the disability benefit to be paid includes a flat-rate portion and an amount equal to 75% of the earned retirement pension. The maximum new monthly disability benefit in 2004 is $992.80 (2003 – $971.26).

Survivor's benefits – A survivor's benefit is payable to the spouse or common-law partner (the beneficiary) of a deceased contributor, according to the provisions of the Act. For a beneficiary under the age of 65, the benefit consists of a flat-rate portion and an amount equal to 37.5% of the deceased contributor's earned retirement pension. A beneficiary between the ages of 35 and 45 who is not disabled or who has no dependent children receives reduced benefits. For beneficiaries aged 65 and over, the benefit is equal

to 60% of the retirement pension granted to the deceased contributor. The maximum new monthly benefit payable to a beneficiary in 2004 is $488.50 (2003 – $480.75).

Disabled contributor's child and orphan benefits – According to the provisions of the Act, each child of a contributor who is receiving disability benefits or who died is entitled to a benefit as long as the child is under the age of 18, or is between the ages of 18 and 25 and attending school full-time. The flat-rate monthly benefit in 2004 is $192.68 (2003 – $186.71).

Death benefits – According to the provisions of the Act, a death benefit is a one-time payment to, or on behalf of, the estate of a contributor. The benefit amounts either to 10% of the maximum pensionable earnings in the year of death or six times the monthly retirement pension granted to the deceased contributor, whichever is less. The maximum death benefit in 2004 is $2,500 (2003 – $2,500).

Pensions and benefits indexation – As required by the Act, pensions and benefits are indexed annually based on the Consumer Price Index for Canada. The rate of indexation for 2004 is 3.2% (2003 – 1.6%).

2. SIGNIFICANT ACCOUNTING POLICIES

a) Basis of presentation

These financial statements present the financial position, the changes in net assets and the cash flows of the Canada Pension Plan. They include the financial position of the CPP Investment Board and the results of its operations. These financial statements are prepared in accordance with Canadian generally accepted accounting principles and conform to the disclosure and accounting requirements of the CPP Act.

These financial statements do not provide information on the actuarial estimates required to meet future obligations of the CPP since the CPP Act does not require that the pensions and benefits be pre-funded.

The CPP, which is under joint control of the Government of Canada and participating provinces, is not considered to be part of the reporting entity of the Government of Canada. Accordingly, its financial activities are not consolidated with those of the Government.

b) Valuation of investments

Bonds held by the CPP Investment Fund and CPP Investment Board investments are stated at fair value. Fair value is the amount of the consideration that would be agreed upon in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act.

Bonds held by the CPP Investment Fund – The fair value is determined by calculating the present value of bonds' projected cash flows. The discount rate used is based as appropriate on the provincial, territorial

or government of Canada market rates. The fair value includes a further discount for the non-marketable and non-transferable characteristics of the bonds.

Bonds issued by the provincial and territorial governments can be redeemed prior to maturity at the option of these governments or renewed for another 20 years. There are distinct calculation methods for bonds early redemption or renewal that do not take into consideration the non-marketable and non-transferable characteristics.

Any early redemption or renewal could therefore result in transactions at amounts that differ from the recorded fair value of the bonds.

CPP Investment Board's investments – The fair value is determined as follows: quoted market prices for publicly traded equities and unit values for pooled funds. Unit values reflect the quoted market prices of the underlying securities.

In the case of private equity investments, where quoted market prices are not available, fair value is determined annually, commencing after the first year of ownership, based on carrying values and other relevant information reported by external managers of the limited partnerships in which the investments are made. These carrying values are determined by the external managers using accepted industry valuation methods.

The fair value of private market investments in income producing properties is determined annually, commencing after the first year of ownership, using accepted industry valuation methods, such as discounted cash flows and comparable purchase and sales transactions.

Fair value for the over-the-counter derivatives such as swaps is determined based on discounted cash flows and market prices for underlying assets with similar characteristics.

Money market securities are recorded at cost which, together with accrued interest income, approximates fair value.

c) Contributions

Contributions include CPP contributions earned for the year. The Canada Customs and Revenue Agency collects contributions and measures them using the assessment of tax returns. In determining the amount of contributions earned for the year, the Agency considers cash received and contributions assessed, and makes an estimate for contributions related to tax returns not yet assessed. This estimate is subject to review and adjustments. Adjustments, if any, are recorded as contributions in the year they are known.

d) Investment income recognition

CPP Investment Fund income is recorded on the accrual basis and includes unrealized gains and losses on bonds held at the end of the year.

CPP Investment Board's net income from operations represents the Investment Board's investment income, less investment and administrative expenses. Investment income is recorded on the accrual basis and includes realized gains and losses on disposal of investments, unrealized gains and losses on investments held at the end of the year, dividend income (recognized on ex-dividend date), interest income, distributions from partnerships and trusts, and net operating income from private market real estate investments.

Realized gains and losses on investments sold during the year represent the difference between sale proceeds and cost, less related costs of disposition. Unrealized gains and losses represent in the difference between the fair value and cost of investments. The current year unrealized gains and losses represent the year-over-year change in this difference.

e) Translation of foreign currencies

Transactions in foreign currencies are recorded at the rates of exchange prevailing on the transaction date. Investments denominated in foreign currencies and held at the year end are translated at exchange rates in effect at the year end date. The resulting realized and unrealized gains and losses are included in investment income.

f) Pensions and benefits

Pensions and benefits are recorded when payable.

g) Net overpayments

Net overpayments are composed of overpayments of pensions and benefits that were established during the year less remissions of debts granted.

h) Administration costs

Administration costs are recorded in the year to which they relate.

i) Measurement uncertainty

The preparation of financial statements in accordance with the Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities as at the date of the financial statements and revenue and expenses for the year. Actual results could differ from these estimates. The most significant estimates are related to contributions, administration costs, allowance for doubtful accounts, the fair value of the bonds held by the CPP Investment Fund and the fair value of investments held by the CPP Investment Board.

3. CHANGE IN ACCOUNTING POLICY

During the year, a legislative amendment was approved which provided for the transfer of CPP assets to the CPP Investment Board (See Note 12).

In order to provide a consistent basis of accounting for the provincial, territorial and federal bonds between the CPP Investment Fund and the CPP Investment Board, the fair value accounting was adopted for bonds in 2004, unlike previous years where the bonds were accounted for at cost. This change in accounting policy was applied retroactively and the prior year's financial statements were restated accordingly.

As a result of this change in accounting policy, unrealized gains and losses on bonds are now recognized in the statement of change in net assets and the bonds are recorded at their fair value in the statement of net assets.

The following summarizes the changes to financial statements as a result of the change in accounting policy for the years presented:

	2004		2003	
	(in millions of dollars)			
	Bonds recorded		Bonds recorded	
	at cost	**at fair value**	at cost	at fair value
Statement of Net Assets				
Assets				
CPP Investment Fund				
Provincial and Territorial bonds	**22,181**	**25,397**	23,204	26,080
Canada bonds	**3,352**	**4,070**	3,369	4,071
Net Assets	**68,576**	**72,511**	53,673	57,251
Statement of Changes in Net Assets				
Net Assets, beginning of year	**53,673**	**57,251**	51,709	55,094
Investment income (loss)	**9,891**	**10,248**	(1,242)	(1,049)
Net Assets, end of year	**68,576**	**72,511**	53,673	57,251

4. INVESTMENTS HELD BY THE CPP INVESTMENT FUND

The Canada Pension Plan Investment Fund was established in the accounts of Canada by the CPP Act to record the Plan's investments in bonds of the provinces, territories and Canada. The CPP Investment Fund's bond portfolio is administered by the federal Department of Finance.

Until the end of 1997, the investments in provincial, territorial and federal government bonds were made with the cash on hand in excess of the Plan's forecast three-month operating requirement. These bonds were not marketable and had a 20-year term (or less) as fixed by the Minister of Finance on the recommendation of the Chief Actuary of the Office of the Superintendent of Financial Institutions. The interest rate on the bonds was determined by the Minister of Finance based on the average yield to maturity of all outstanding Government of Canada obligations with terms of 20 years or more. When these bonds matured, funds not required for payment of pensions and benefits were re-invested in new bonds.

Beginning in 1998, a maturing provincial or territorial bond may be re-invested in a new bond only once for a term of 20 years, if both the issuer asks to do so and the operating balance is sufficient to pay current pensions and benefits. Excess funds not re-invested are transferred to the CPP Investment Board. The re-invested bonds remain not marketable and bear interest at a rate fixed by the Minister of Finance. The interest rate is substantially the same rate that the province would pay if it were to borrow the same amount for the same term through the issuance of a bond on the public capital markets. Interest earned on the investments is paid semi-annually to the CPP Account.

During the year, all disposals of bonds were made, at maturity date, at face value. The bonds are redeemable in whole or in part before maturity. Since January 31, 2001, the provinces and territories are permitted to redeem their bonds held by the CPP Investment Fund prior to their maturity at a value equivalent to market value. No bonds were redeemed by the provinces and the territories prior to maturity during the year ended March 31, 2004 (2003 – none).

The bonds held by the CPP Investment Fund are exposed to interest rate risk. Interest rate risk refers to the risk of an adverse change in the fair value of the bonds as a result of an unfavourable movement in market interest rates.

The following schedule provides information on the disposals, re-investments, unrealized gains / (losses) and balance of the Investment Fund:

CPP Investment Fund

(in millions of dollars)

	March 31, 2003 at cost	Disposals	Re-Investments	**March 31, 2004 at cost**	**March 31, 2004 at fair value**	March 31, 2003 at fair value
Newfoundland	633	51	51	**633**	**714**	700
Prince Edward Island	140	11	11	**140**	**159**	156
Nova Scotia	1,079	91	91	**1,079**	**1,232**	1,212
New Brunswick	834	71	71	**834**	**940**	920
Quebec	96	5	5	**96**	**111**	108
Ontario	10,746	1,201	688	**10,233**	**11,687**	12,065
Manitoba	1,128	126	–	**1,002**	**1,167**	1,292
Saskatchewan	1,151	109	40	**1,082**	**1,241**	1,299
Alberta	3,385	441	200	**3,144**	**3,661**	3,860
British Columbia	4,008	375	301	**3,934**	**4,481**	4,464
Yukon Territory	4	–	–	**4**	**4**	4
	23,204	2,481	1,458	**22,181**	**25,397**	26,080
Canada	3,369	17	–	**3,352**	**4,070**	4,071
	26,573	2,498	1,458	**25,533**	**29,467**	30,151

The further discount included in the fair value to allow for the specific characteristics of the bonds is valued at $1.26 billion ($1.27 billion in 2003). The following schedule presents the bonds by maturity dates and the weighted-average annual rate of return on bonds currently held.

	2004		(in millions of dollars) 2003	
	Investments at cost	**Average coupon**	Investments at cost	Average coupon
Investments maturing				
Within 1 year	**2,283**	**13.35%**	2,498	11.77%
1 – 5 years	**9,429**	**10.23%**	9,700	10.99%
Over 5 years	**13,821**	**8.37%**	14,375	8.90%
Total – Investments	**25,533**		26,573	
Weighted-average yield on investments		**9.50%**		9.93%

5. INVESTMENTS HELD BY THE CPP INVESTMENT BOARD

The Canada Pension Plan Investment Board (CPPIB) was established by an Act of Parliament in 1997. The *Canada Pension Plan Investment Board Act* came into force on April 1, 1998. The purpose of the Board is to invest the funds transferred by the CPP in a diversified portfolio of investments. The Board is designed to operate at arm's length from the government. It is required to be accountable to the public, Parliament (through the federal Minister of Finance), and the provinces and provides regular reports of its activities and the results achieved.

The following schedule provides information on the Board's investments as at March 31.

	2004	2003
	(in millions of dollars)	
Canadian equities, at fair value		
Public Markets	**18,046**	11,051
Private Markets	**282**	261
	18,328	11,312
Non-Canadian equities, at fair value		
Public Markets	**7,552**	4,245
Private Markets	**1,530**	1,265
	9,082	5,510
Total Equities (Cost 2004 – $25,034; 2003 – $20,336)	**27,410**	16,822
Real Return Assets		
Public markets real estate	**350**	219
Private markets real estate	**432**	246
Private markets infrastructure	**22**	–
Total Real Return Assets (Cost 2004 – $829; 2003 – $645)	**804**	465
Money Market Securities (Cost 2004 – $4,784; 2003 – $575)	**4,777**	575
Investment Receivables (Cost 2004 – $68; 2003 – $41)	**68**	41
Investment Liabilities (Cost 2004 – $170; 2003 – $452)	**(171)**	(449)
Net fair value of Derivatives	**6**	(1)
Total Net Investments	**32,894**	17,453

The CPP Investment Board has established investment policies which set out the manner in which assets shall be invested. In determining the asset mix, the CPP Investment Board takes into consideration certain assets of the CPP which are held outside the CPP Investment Board.

In accordance with the Invesment Policy, at least 70% of the book value of the CPP Investment Board's portfolio is allocated to Canadian investments and the remainer to non-Canadian investments.

The CPP Investment Board's investments are mainly allocated to equities. During the current year, the CPP Investment Board made its first investment in a private market infrastructure fund. The CPP Investment Board also obtains exposure to real estate through investments in publicly traded securities and privately held real estate. Private real estate investments are held by subsidiary and are managed on behalf of the CPP Investment Board by external advisors and managers through co-ownership arrangements.

Derivative Contracts

A derivative is a financial contract, the value of which is derived from the value of underlying assets, indexes, interest rates or currency exchange rates.

The CPP Investment Board uses derivatives primarily to replicate the return of Canada and Non-Canadian equity indexes. As at March 31, 2004, the CPP Investment Board has equity swaps outstanding to exchange money market interest for equity returns. The CPP Investment Board also uses exchange-traded futures contracts to achieve the desired broad market exposure to the equity markets while cash is being held to fund investment activities.

All derivative contracts have a term to maturity of one year or less. Notional amounts of derivative contracts are used to compute the cash flows and for determining the fair value of the contracts.

Notional amounts are not recorded as assets or liabilities on the balance sheet. The notional amounts and fair value of derivative contracts held as at March 31 are as follows:

	2004		2003	
			(in millions of dollars)	
	Notional Amount	**Fair Value**	Notional Amount	Fair Value
Equity swaps	**4,034**	**9**	250	(1)
Equity futures	**448**	**(3)**	–	–
Total	**4,482**	**6**	250	(1)

Consistent with the investment policies, derivative contracts are fully covered by money market securities. The economic impact on the total asset mix is to increase Canada and Non Canada equities exposure by 12.9% (2003 – 1.4%) and 0.8% (2003 – Nil%), respectively, with a corresponding decrease in money market securities exposure.

Securities Lending

The CPP Investment Board participates in a securities lending program to enhance portfolio returns. Credit risk associated with the securities lending program is mitigated by requiring the borrower to provide daily collateral in the form of readily marketable investments of greater market value than the securities loaned. As at March 31, 2004, the CPP Investment Board's investments include loaned securities with an estimated fair value of $721 million (2003 – $Nil). The fair value of collateral received in respect of these loans is $758 million (2003 – $Nil).

CPP Investment Board's Investment Risks

The CPP Investment Board limits credit risk by dealing with counterparties that have a minimum credit rating of A or R-1 (short term) as determined by a recognized credit rating agency, where available, or as determined through an internal credit rating process. Credit exposure is limited to maximum amounts approved by the Board of Directors.

The CPP Investment Board is exposed to currency risk through holdings of non-Canadian investments, investment receivables and investment liabilities. Investments are not hedged against changes in foreign exchange rates.

Commitments

The CPP Investment Board has committed to enter into investment transactions, which will be funded over the next several years in accordance with the agreed terms and conditions. As at March 31, 2004, these outstanding commitments total $3.9 billion (2003 – $3.9 billion). The organization has made lease commitments of $21.0 million over the next 10 years.

Other Information

The CPP Investment Board is exempt from Part I tax under paragraph 149 (1) (d) of the *Income Tax Act* (Canada) on the basis that all of the shares of the CPP Investment Board are owned by Her Majesty in right of Canada. The CPP Investment Board's subsidiaries are exempt from Part I tax under paragraph 149 (1) (d.2) of the *Income Tax Act* (Canada) on the basis that all of the shares of the subsidiaries are owned by a corporation whose shares are owned by Her Majesty in right of Canada.

The CPP Investment Board's audited financial statements for the year ended March 31, 2004 are publicly available and provide details concerning the Board's investment policy, its investments and portfolio returns.

6. RECEIVABLES FROM BENEFICIARIES

	2004	2003
	(in millions of dollars)	
Balance of pensions and benefits overpayments	**81**	77
Allowance for doubtful accounts	**(45)**	(28)
	36	49

Social Development Canada has procedures to detect overpayments. During the year, overpayments totalling $45 million (2003 – $45 million) were established and remissions of debts totalling $4 million (2003 – $4 million) were granted. A further $37 million was recovered (2003 – $37 million).

7. CANADA PENSION PLAN ACCOUNT

The CPP Account was established in the accounts of Canada by the CPP Act, to record the contributions, interest, pensions, benefits and administration costs of the Plan. It also records the amounts transferred to or received from the CPP Investment Fund and the CPP Investment Board.

The balance of the CPP Account included the Deposit with Receiver General for Canada and short-term investments, if any. As at March 31, the Deposit with Receiver General for Canada amounts to $7,483 million (2003 - $7,093 million).

8. CONTRIBUTIONS

Contributions for the year are measured by Canada Customs and Revenue Agency (CCRA) using the assessment of tax returns. In determining the amount of contributions earned for the year, the Agency considers cash received and contributions assessed and makes an estimate for contributions related to tax returns not yet assessed.

Actual results may differ from these estimates. Actual contribution amounts for calendar years 2003 and 2004 will only be known once CCRA has processed all employer's and self-employed workers' declarations of contributions for these years. An adjustment for the difference between actual and estimated contributions will be recorded in the fiscal year in which the adjustment is known.

9. INVESTMENT INCOME/(LOSS)

	2004	2003
	(in millions of dollars)	
CPP Investment Fund income:		
Interest on bonds	**2,500**	2,741
Net unrealized gains	**357**	193
	2,857	2,934
Interest on deposit with the Receiver General for Canada at a weighted-average annual rate of 2.59% (2003 – 2.64%)	**182**	169
CPP Investment Board net income/(loss) from operations:		
Net unrealized gains/(losses)	6,050	(3,264)
Fund distributions of capital gains and dividends	–	361
Net realized gains/(losses)	658	(1,533)
Dividend Income	**504**	288
Other investment income	**21**	9
Investment and administrative expenses	(24)	(13)
	7,209	(4,152)
	10,248	(1,049)

10. ADMINISTRATION COSTS

	2004	2003
	(in millions of dollars)	
Pension and benefit delivery, accommodation and corporate services (Human Resources Development Canada)	**309**	328
Collection of contributions (Canada Customs and Revenue Agency)	**85**	80
Cheque issue and computer services (Public Works and Government Services Canada)	**15**	13
Actuarial services (Office of the Superintendent of Financial Institutions)	**1**	1
	410	422

Administration costs of the CPP represent the cost of services received from a number of federal government departments and an agency. Those costs are based on estimated allocations of costs and are charged to the CPP in accordance with the memoranda of understanding.

11. CONTINGENCIES

At March 31, 2004, there were 4,403 (5,140 in 2003) appeals relating to the payment of CPP pensions and benefits. Claims for these appeals could reach a maximum estimated amount of $22 million ($22 million in 2003). Any award made in favour of beneficiaries will be accounted for as an expense of the period in which the amount becomes payable.

A class action has been filed against the CPP for discrimination against survivors whose same-sex common-law partners died on or after April 17, 1985 and before January 1, 1998. On December 19, 2003, the Ontario Superior Court ruled in favour of the class members. The Government has appealed the decision to the Court of Appeal for Ontario. The appeal was heard in Toronto in June 2004. At the time of the preparation of the financial statements, the outcome of the hearing was not known. This contingency is evaluated at an amount between $71 and $132 million.

12. LEGISLATIVE AMENDMENT

Legislation to amend the Canada Pension Plan and the *Canada Pension Plan Investment Board Act* was passed by Parliament on April 3, 2003, and approved by an Order in Council on March 22, 2004. The amended legislation and a related administrative agreement provide for the transfer of CPP assets currently administered by the federal government to the CPP Investment Board beginning in fiscal year 2005. These assets consist of the bonds held by the CPP Investment Fund and the Deposit with Receiver General for Canada. CPP Investment Board, the departments of Finance and Social Development have signed an agreement outlining the process for the transfer of assets. The bonds held by the CPP Investment Fund will be transferred to CPP Investment Board over a three-year period beginning with the first transfer on May 1st, 2004. The Deposit with Receiver General for Canada will be transferred over a period of twelve months beginning in September 2004.

13. COMPARATIVE FIGURES

Certain comparative figures have been reclassified to conform to the current year's presentation.

ANNUAL REPORT OF THE

Canada Pension Plan

2003-2004

Canada Pension Plan

ANNUAL REPORT OF THE

Canada Pension Plan

2004-2005

Government of Canada Gouvernement du Canada

Canada

ANNUAL REPORT OF THE CANADA PENSION PLAN

Fiscal Year 2004-2005

ISPB 203-06-06E

Publication of the *2004-2005 Annual Report of the Canada Pension Plan* was delayed due to a number of organizational and governmental changes.

As of February 2006, the legal names of the minister and department responsible for the Canada Pension Plan (CPP) are the Minister of Human Resources and Skills Development and the Department of Human Resources and Skills Development respectively. Operationally, the Department is known as Human Resources and Social Development Canada (HRSDC).

The names of the departments previously responsible for the CPP, namely Human Resources Development Canada (HRDC) and/or Social Development Canada (SDC), are used in this report in a historical context only.

Produced by the the Department of Human Resources and Skills Development Canada, in collaboration with: the Department of Finance, the Canada Revenue Agency, Public Works and Government Services Canada, and the Office of the Superintendent of Financial Institutions.

If you need additional copies of this report, it is available for printing at **www.hrsdc.gc.ca**.

Or you may contact:

HRSDC
Publications
Ottawa ON
K1A 0L1
Fax: (613) 948-9450

Aussi disponible en français sous le titre *Rapport annuel du Régime de pensions du Canada 2004-2005*.

To give feedback on the Annual Report, see our form online at **www.hrsdc.gc.ca** under "Publications".

For more detailed information about subjects covered in this report, or about the Canada Pension Plan in general, please visit **www.hrsdc.gc.ca**.

If you have questions, please call (free of charge from Canada and the U.S.):

1 800 277-9914 (English)
1 800 277-9915 (French)
1 800 255-4786 (TTY)

Cat. No SD15-2/2005E
ISBN 0-662-69376-0

Government of Canada Gouvernement du Canada

Her Excellency
The Governor General of Canada

May it please Your Excellency:

We have the pleasure of submitting the *Annual Report of the Canada Pension Plan* for the fiscal year 2004-2005.

Respectfully,

James M. Flaherty
Minister of Finance

Diane Finley
Minister of
Human Resources and Skills Development

Canada

Contents

This report on the Canada Pension Plan (CPP) consolidates input from all departments involved in the administration of the Plan: Social Development Canada (now Human Resources and Skills Development Canada), the Department of Finance, the Canada Revenue Agency (CRA), Public Works and Government Services Canada (PWGSC), and the Office of the Superintendent of Financial Institutions (OSFI).

2004-2005: The Year at a Glance

IN FISCAL 2004-2005:

- Following extensive consultations with the provinces, the Government of Canada proposed changes to both the disability benefit and the rules governing employer contributions in the 2004 budget. These changes—which include automatic reinstatement, and clarification of the annual amount of employers' contributions—were included in the budget implementation bill that received Royal Assent in May 2004. (CPP changes come into force through an Order-in-Council process with the formal consent of two-thirds of the provinces.)
- Changes to the *Canada Pension Plan Regulations* were implemented on January 1, 2005, to reflect the statutory increase in maximum pensionable earnings ($41,100 for 2005). The contribution rate remained unchanged at 9.9 percent.
- 4.5 million Canadians received benefits from the Canada Pension Plan, with a total value of approximately $23.8 billion.
- About 3.1 million people received $16.8 billion in CPP retirement pensions.
- About 945,000 surviving spouses or common-law partners and 85,000 children of deceased contributors received over $3.5 billion in CPP benefits.
- About 291,000 persons with disabilities and 89,000 of their children received almost $3.2 billion in CPP disability benefits.
- Death benefits amounted to some $0.3 billion.
- 11.4 million people contributed to the CPP in 2004.
- 2.2 million people received Statements of Contributions.
- Administrative costs amounted to approximately $386 million, or 1.62 percent of the $23.8 billion in benefits paid. This compares favourably with administrative costs for other large pension plans and individual RRSPs.
- On March 31, 2005, total CPP assets were valued at approximately $83.4 billion. The assets were held in provincial, territorial and federal government bonds, deposits with the Receiver General for Canada, the receivables net of liabilities, domestic and foreign publicly traded equities, as well as private equity, real estate and infrastructure assets. Bonds, equities and real estate and infrastructure are stated at fair value.

The Canada Pension Plan in Brief

Almost everyone who participates in the paid labour force in Canada contributes to the Canada Pension Plan (CPP) or to its sister plan, the Quebec Pension Plan (QPP), and will at some time benefit from their provisions.

Established by an act of Parliament in 1965 and implemented in 1966, the CPP is a jointly managed federal-provincial plan. Quebec manages and administers its own plan, the QPP, and participates in the decision making of the CPP. Benefits from either plan are based on pension credits accumulated under both. The plans are financed through mandatory contributions from employees, employers and self-employed people, as well as from investment income. (Information on the QPP is available from the Régie des rentes du Québec at www.rrq.gouv.qc.ca.)

While it is perhaps best known for its retirement pensions, the CPP also provides children's, survivor, disability and death benefits. The CPP administers the largest long-term disability plan in Canada. Vocational rehabilitation services and return to work supports assist some disability beneficiaries to regain their independence by helping them engage in work activities.

Benefit calculations are based on how much and for how long a contributor has paid into the CPP and, in some cases, the age of the beneficiary. Benefits are not paid automatically—everyone must apply and provide proof of eligibility. Benefits are adjusted in January of each year as needed to reflect increases in the average cost of living, as measured by the Consumer Price Index.

Many Canadians live and work in other countries. Others move here after contributing to a public pension plan elsewhere. To help protect their pensions, Canada has entered into social security agreements with several other nations. These agreements enable Canadians to receive public pensions from other countries and to receive CPP payments abroad. They also permit continuity of social security coverage when Canadians are temporarily working outside the country, eliminate duplicate contribution payments, and help them meet eligibility requirements for CPP and for other countries' public pensions.

Ensuring Financial Sustainability

As joint stewards of the CPP, the federal and provincial ministers of Finance review the Plan's financial state every three years and make recommendations as to whether benefits and/or contribution rates should be changed. They base their recommendations on a number of factors, including the results of an examination of the Plan by the Chief Actuary. The Chief Actuary is required under the legislation to produce an actuarial report on the CPP every three years (in the year before the legislated ministerial review of the Plan). The CPP legislation also requires the Chief Actuary to prepare an actuarial report any time a Bill is introduced in Parliament that, in the view of the Chief Actuary, has a material impact on the estimates in the most recent triennial actuarial report. This reporting ensures that the long-term financial implications of proposed Plan changes are given due consideration.

Changes to the CPP legislation governing the general level of benefits, the rate of contributions or the investment policy framework can be made only through an act of Parliament. All such changes require the agreement of at least two thirds of the participating provinces, representing at least two thirds of the population. The changes come into force only after two years' notice, unless there is agreement to waive this requirement, and after Provincial Orders-in-Council confirming the changes have been passed. Quebec participates in decision-making regarding changes to the CPP legislation, even though it administers its own plan. It is important that Quebec be involved in changes to the CPP to ensure the portability of QPP and CPP benefits across Canada.

The legislation requires that federal and provincial ministers make best efforts to complete the next financial review of the Canada Pension Plan by the end of 2005. Ministers will base their review on a number of factors, including the conclusions of the *Twenty-first Actuarial Report* on the Canada Pension Plan, prepared by the Chief Actuary of the Canada Pension Plan for the purpose of the review. The previous triennial financial review of the Plan by ministers was in 2002. In the 2002 review, ministers concluded that the Plan was financially sustainable and agreed to make no changes to the Plan. Further information on this and previous reviews of the Plan can be found at **www.cpp-rpc.gc.ca**.

ACTUARIAL REPORTING

The *Twenty-first Actuarial Report* was tabled in Parliament by the Minister of Finance in December 2004. The report presented the financial status of the Plan as at December 31, 2003 and provides information to evaluate the Plan's financial sustainability over a long period, assuming Plan provisions remain unchanged. The findings of the report are an important element in the federal and provincial finance ministers' triennial financial review of the CPP for 2005. The last triennial financial review of the Plan by ministers was based on the findings of the *Eighteenth Actuarial Report* (as at December 31, 2000). Since this report, the Canada Pension Plan was subject to a series of amendments, whose financial implications were outlined in the *Nineteenth* and *Twentieth Actuarial Reports*.

Federal and provincial finance ministers have endorsed regular peer reviews of triennial actuarial reports. For this purpose, a panel of three independent Canadian actuaries, selected through an arm's length process, reviewed the *Twenty-first Actuarial Report*. The findings of the independent panel indicates that the Report was competently prepared, the Report's assumptions are reasonable and as a result, the conclusions of the Chief Actuary that the CPP is financially stable are well supported. It also stated that the Report meets current professional standards of actuarial practice and uses data and methodologies

that are appropriate and reasonable. Canadians can have confidence in the results of the *Twenty-first Actuarial Report* and the conclusions reached by the Chief Actuary about the long-term financial health of the Plan.

In addition to its conclusions, the panel made a number of recommendations regarding the preparation of future actuarial reports. Like previous reviews, the Office of the Chief Actuary will study the panel's recommendations and give them due consideration in the preparation of future triennial actuarial reports. Since 1997, the OCA has developed a strong peer review process for its work. The panel's report and recommendations, as well as the actuarial reports and previous peer reviews can be found at **www.osfi.gc.ca**.

A FAIR APPROACH TO FUNDING

When it was introduced in 1966, the CPP was designed as a pay-as-you-go plan, with a small reserve. This meant that the benefits for one generation would be paid largely from the contributions of later generations. This approach made sense under the economic, financial and demographic circumstances of the time. The period was characterized by a rapid growth in wages and labour-force participation, and low rates of return on investments.

The pay-as-you-go approach also allowed the federal and provincial governments to keep contributions at a reasonable level while beginning to pay full retirement benefits as early as the mid-1970s. This was important—many of the seniors who received benefits at that time had been unable to accumulate sufficient retirement savings. However, demographic and economic developments and changes to benefits in the 30 years that followed resulted in significantly higher costs. When federal and provincial finance ministers began their five-year statutory review of the CPP finances in 1996, contribution rates, already legislated to rise to 10.1 percent by 2016, were expected to have to rise again—to 14.2 percent by 2030—to continue to finance the Plan on a pay-as-you-go basis.

Continuing to finance the Plan on a pay-as-you-go basis would have meant imposing a heavy financial burden on Canadians in the workforce 25 years down the road, which was deemed unacceptable by the federal and provincial governments. Therefore, in 1997, they agreed instead to change the funding approach of the Plan to a hybrid of pay-as-you-go and full funding. Under full funding, each generation pays for its own benefits.

Steady-state Financing

To reduce the burden on future generations, the federal and provincial governments introduced "steady-state" financing as part of the 1997 reform agreement. This approach requires that contribution rates be set no lower than the lowest rate expected to ensure the long-term financial stability of the Plan without recourse to further rate increases. At the time of the reforms, this was determined to be 9.9 percent. Therefore, under steady-state financing, the contribution rate was scheduled to increase incrementally (from 5.6 percent in 1996) to 9.9 percent in 2003, and to remain at this level thereafter.

According to the Chief Actuary of Canada, steady-state financing will generate a level of contributions that exceeds the benefits paid until 2022. Funds not immediately required to pay benefits will be transferred to the CPP Investment Board for investment.

Plan assets will accumulate rapidly over this period and over time will help pay the growing costs that are expected as more and more «baby boomers» begin to collect their retirement pension.

In 2022 and thereafter, when most of the baby boomers have retired, and benefits paid begin to exceed contributions, investment revenues from the CPP's accumulated assets will provide the funds necessary to make up the difference. However, contributions will remain the main source of funding for benefits.

The steady-state financing approach has moved the CPP away from pay-as-you-go financing (with a small reserve) towards fuller funding. By 2025, the Plan is expected to be about 25 percent pre-funded (i.e., Plan assets cover about 25 percent of benefits in pay and earned to that date) compared to about 7 percent funded at the time of the 1997 agreement. The move to steady-state financing and the other changes agreed to in 1997 have reduced the relative size of the Plan's unfunded liability in a manner that is fair across generations. Moving to full-funding, which would have eventually eliminated the unfunded liability would have created unfairness across the generations. During the transition, contributors of some generations would have paid much higher contributions than others—they would have had to pay for the benefits of current retirees and for the development of a reserve to cover their own pensions. Continuing with a pay-as-you-go approach would also have been unfair, as it would have meant a sharp increase in the contribution rate over the coming decades.

According to the *Twenty-first Actuarial Report*, as at December 31, 2003, Plan assets cover about 12 percent of the Plan's current and accrued benefit obligations. The balance of accrued obligations, or $516.3 billion in current dollars, are not backed by assets. The relative size of this liability will decline over time as Plan assets grow more rapidly than Plan liabilities in the next few decades (thereafter Plan assets will grow at least as quickly as Plan liabilities). The projected growth of assets and liabilities and the evolution of the funding level over time are better measures of the long-term financial health of the CPP that is the $516.3 billion in actuarial liabilities not covered by assets.

A partially funded CPP not only balances the two approaches to funding, but also contributes to diversifying the funding of Canada's retirement income system:

- the Old Age Security program, funded by federal government revenues, and
- private savings, including tax-deferred, fully funded employer-sponsored pension plans and registered retirement savings plans (RRSPs).

A diversified funding approach allows Canada's retirement income system to be less vulnerable to changes in economic and demographic conditions than are systems in countries that use a single funding approach. In addition, the Canadian approach to pension provision, based on a mix of public and private pensions, is an effective way to provide for retirement income needs, according to international organizations.

Financial Accountability

Since 1999-2000, the CPP has used the accrual basis of accounting for revenues and expenditures. This method gives administrators a detailed financial picture and allows accurate matching of revenue and expenditures in the year in which they occur.

As at March 31, 2005, total CPP net assets were valued at approximately $83.4 billion. Net Plan assets are contributions and investment income that have accumulated since the Plan's inception in 1966—less benefit and administrative expenditures over the same period. According to the Chief Actuary, Plan assets are expected to increase appreciably over the next 20 years.

CPP ACCOUNT

A separate account, the CPP Account, has been established in the accounts of the Government of Canada to record the financial elements of the Plan: contributions, interest, pensions and other benefits paid, and administrative expenditures. The CPP Account also records the amounts transferred to or received from both the CPP Investment Fund and the CPP Investment Board. Spending authority is limited to the Plan's net assets. The CPP assets are not part of the federal government's revenues and expenditures.

Prior to the coming into force of Bill C-3 (*An Act to Amend the Canada Pension Plan and the Canada Pension Plan Investment Board Act*), the Canada Pension Plan Investment Board was responsible for investing net new funds, while the CPP Account's operating balance and bond portfolio were managed by the Government of Canada. The amended legislation provides for the transfer of CPP assets that were previously administered by the federal government to the CPP Investment Board, beginning in 2004. These assets consist of the bonds held by the CPP Investment Fund and a portion of the deposit with the Receiver General for Canada. The CPP Investment Board and the federal government have signed an agreement governing the transfer of the assets. The bonds will be transferred to the Board over a three-year period beginning in May 2004. Funds on Deposit with the Receiver General for Canada will be transferred over a period of twelve months beginning in September 2004.

CPP INVESTMENT BOARD

The CPP Investment Board was created by an Act of Parliament in December 1997 to invest funds not required by the Canada Pension Plan to pay current benefits.

The Board is independent of the CPP. It operates at arm's length from government and is overseen by an independent board of directors. Its legislated mandate is to manage funds transferred from the CPP in the best interests of the contributors and beneficiaries of the Plan. The Board is to invest CPP assets with a view to achieving a maximum rate of return, without undue risk of loss. It must also consider the factors that affect the Plan's funding and its ability to meet its financial obligations.

The CPP Investment Board has a long-term investment horizon. In his most recent report, the Chief Actuary of Canada estimates that contribution revenues will exceed CPP benefit payments and expenses well into the future, and that the CPP will not need money from investment income until 2022.

Further information on the Board's mandate, governance structure and investment policy can be found at **www.cppib.ca**.

CPP Investments

As at March 31, 2005, CPP investments consisted of $31.7 billion of fixed income securities, $2.9 billion of private equity and $1 billion of real estate and infrastructure and $45.7 billion in publicly traded stocks.

The CPP reserve fund earned $6.1 billion for the fiscal year ending March 31, 2005.

Investing for our future

The CPP Investment Board believes that publicly traded equities will outperform fixed income assets over the long term. Consequently, the Board will continue to invest in publicly traded equities or stocks so that CPP assets are allocated in a way that reflects the long-term funding requirements of the Plan.

Prior to March 31, 2004—the end of the 2003-04 fiscal year—the CPP Investment Board's public equity investments replicated well-known indexes for Canadian, U.S. and non-North American stocks. In fiscal 2004, the CPP Investment Board began to invest its passive portfolio on an economic sector basis from a global perspective. This new approach allows the Board to take into account the nature of Canada Pension Plan liabilities and avoid concentrating risk in certain sectors or individual stocks.

As at March 31, 2005, private equity commitments by the CPPIB were approximately $8.3 billion, of which $3.4 billion had been invested. These commitments involve 57 investments managed by 43 different private equity firms. In general, the CPPIB approach to private equity is to invest through a long-term limited partnership with a professional management firm, or general partner, that manages the private equity portfolio. The CPP Investment Board makes a commitment to the general partner's fund that is gradually drawn down as investments are made.

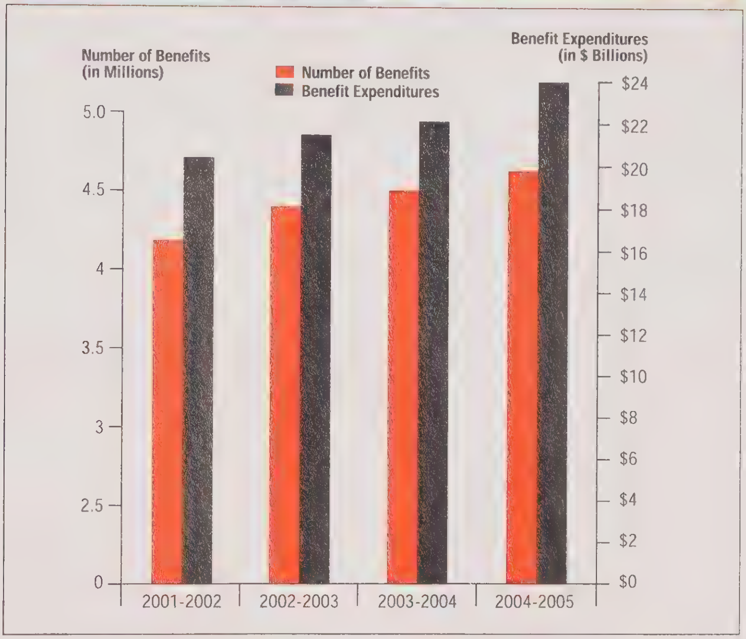
Like other major pension funds, the CPP Investment Board is looking for opportunities to increase investments in real return assets, such as real estate and infrastructure, because their value over time will likely track and surpass the general rate of inflation.

In compliance with its statutory requirement to hold a public meeting in the capital of each participating province at least once every two years, the Board held public meetings in the provincial capitals in January 2001, June 2002 and September and October 2004. The next meetings are scheduled for 2006.

Benefits and Expenditures

The number of people receiving CPP benefits has increased steadily over the past decade. To pay for these benefits, expenditures have also increased. Figure 1 shows the yearly increases since 2001-02. Figure 2 (page 13) shows the percentage of expenditures by type of benefit.

Figure 1 – BENEFITS AND EXPENDITURES BY FISCAL YEAR



RETIREMENT PENSIONS

Retirement pensions represent 67 percent of the total number of CPP benefits and 71 percent of the total benefit dollars paid out by the CPP in 2004-05. The amount of each contributor's pension depends on how much and how long he or she has contributed and at what age he or she begins to draw the benefits. In March 2005, the monthly maximum retirement pension was $828.75; the average payment was $464.20.

The CPP offers flexibility with respect to the age of retirement. Seniors can take their pension as early as the age of 60 or receive a larger pension if they wait until after they turn 65 to begin receiving it. The CPP permanently reduces the pension by 0.5 percent per month for those who take their pension before their 65th birthday, reflecting the fact that these seniors will, on average, receive their benefits longer than someone who retires at the age of 65. For those who take their pension after their 65th birthday, the CPP permanently increases the

pension by 0.5 percent per month (up to a maximum of 30 percent), reflecting the fact that these seniors will receive their benefits for a shorter amount of time on average. The adjustments are intended to ensure that there is no advantage or disadvantage from taking the retirement benefit at a particular age. The Chief Actuary of the Canada Pension Plan completed a study on this issue in March 2003. The study is available at **www.osfi.gc.ca**.

DISABILITY BENEFITS

Disability benefits, paid to eligible contributors and their children, represent 8 percent of the total number of CPP benefits and 13 percent of the total benefit dollars paid out by the CPP in 2004-05. In March 2005, the maximum monthly disability benefit was $1,010.23; the average payment was $756.39. The children's monthly benefit was a flat rate of $195.96.

As part of Bill C-30, an amendment to the *Canada Pension Plan* was passed by Parliament in May 2004 to allow for automatic reinstatement of CPP disability benefits. The required provincial consent was obtained, and the reinstatement amendment came into force January 31, 2005.

This change allows CPP disability clients who return to work to have their benefits quickly restarted if they cannot continue working because their disability recurs. This entitlement is available on application, for two years after CPP disability benefits are stopped because a client returns to regular employment. The provision covers CPP disability clients who report a return to regular employment and whose benefits are stopped on or after January 31, 2005.

SURVIVOR BENEFITS

Survivor benefits, paid to the surviving spouse or common-law partner of the contributor and his/her dependent children, represent 23 percent of the total number of CPP benefits and 15 percent of the total benefit dollars paid out by the CPP in 2004-05. The amount of the monthly survivor benefit varies depending on a number of factors, including the age of the spouse or common-law partner at death and whether the beneficiary also receives other CPP benefits.

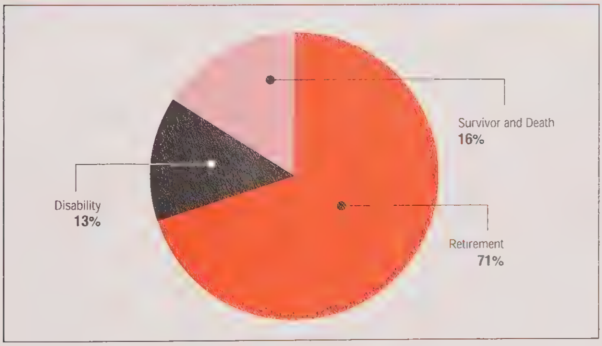
DEATH BENEFITS

Death benefits represent 2 percent of the total number of CPP benefits and 1 percent of the total benefit dollars paid out by the CPP in 2004-05. The death benefit is a one-time payment. The maximum payable is $2,500; the average payment in March 2005 was $2,203.65.

OTHER PROVISIONS

The CPP includes provisions that compensate for periods of low earnings, namely the Child Rearing Provision (CRP) and the 15 percent general drop-out provision. The CRP allows the CPP to drop up to seven years of low or zero earnings (while caring for a child under the age of seven) from the calculation of a contributor's CPP disability, survivor and/or retirement benefit. The 15 percent general drop-out provision is for low or zero earning years and applies to all contributors. The Plan has other provisions under which married or common-law spouses may either share their retirement pensions (where the union is intact) or split their credits (where the union has dissolved).

Figure 2 – PERCENTAGE OF BENEFIT DOLLARS PAID FOR 2004-2005



THE APPEALS PROCESS

There are three opportunities for review of a person's CPP benefit application. Most requests for review concern an application for disability benefits.

The first opportunity involves a request to the Minister of Human Resources and Skills Development (see note on the inside cover of this report) for a reconsideration (or administrative review) of a decision concerning a benefit or a division of pension credits.

A person who is not satisfied with the decision made at the departmental reconsideration level can appeal to a Review Tribunal. A Review Tribunal is an independent body made up of three people chosen by the Commissioner of Review Tribunals from a panel of 100 to 400 part-time members appointed by the Governor-in-Council.

In 2004-05, the Office of the Commissioner of Review Tribunals (OCRT) received 4,072 appeals under the Canada Pension Plan. In that same period, the OCRT issued 3,315 decisions, of which 1,661 (50 percent of the total) were decided in favour of the appellant. In addition, another 385 cases were concluded as a result of settlements offered by Social Development Canada.

The final opportunity for appeal is the Pension Appeals Board, which is an administrative tribunal operating at arm's length from the government. Board members are judges or former judges of the federal court or superior court of a province. Hearings are not automatic. The claimant or the Minister must first request "leave to appeal" and in 2004-05, 83 percent of applications were granted leave. Of the 1044 applications received, 94 percent concerned disability benefits. With respect to all final decisions in all categories, 51 percent were in favour of the claimant. Decisions at this final level of appeal may be sent to the Federal Court for judicial review. The Federal Court may decide to uphold the decision or return it to the Pension Appeals Board for a new decision.

Improved Service Delivery

REACHING OUT TO CANADIANS

During 2004-05, SDC continued its efforts to help Canadians better understand public pensions and the retirement income system, and to encourage them to actively plan and prepare for their own retirement. Information on the CPP is available in print, on the Internet, in person at local offices, by phone, and at electronic kiosks in government offices and public buildings. Personalized contact with clients continued to receive high priority. In 2004-05, SDC issued personal CPP Statements of Contributions to more than 2.2 million contributors between the ages of 18 and 70. The statements were accompanied by information on the retirement income system in Canada.

DELIVERING SERVICE

In 2004-05, SDC continued to modernize CPP program delivery. With the multi-year Information Technology Renewal project, staff now have access to a consolidated view of complete CPP and OAS client and benefit information, benefit payment history and lifetime CPP contributions. In addition, fully automated adjudication (determination of eligibility and calculations of entitlement) has been introduced for CPP retirement benefits. Capabilities for automated adjudication of additional benefits will continue over the next several years. At the same time, the Department continues to focus on maintaining the existing CPP information technology systems.

PROCESSING BENEFITS

CPP services are offered in person, by telephone, online and by mail. In 2004-05, staff received 61,432 disability applications. Decisions on 70 percent of all CPP disability applications, which are complex and require medical information, were made within 120 calendar days of receipt of the completed application. Improved communication with clients and their physicians helped staff make well-informed decisions and helped CPP disability applicants better understand the reasons for decisions. As a result, close to 80 percent of the applications for disability benefits in 2004-05 were finalized in the initial stages.

TABLE 1 – APPLICATION PROCESSING STATISTICS

National measures	Objective	2004-05 National Average
CPP Retirement applications where the benefits were paid on time*	85%	89%
OAS Basic applications where the benefits were paid on time*	90%	93%
CPPD Initial decisions made within 120 calendar days	75%	70%
CPPD Reconsideration decisions made within 120 calendar days	70%	67%

* "On time" refers to the application processed where benefits were paid out within one month of the application being received.

TABLE 2 – TELEPHONE SERVICE STATISTICS

	Objective	2004-05 National Average
Clients served by a service agent within 180 seconds of placing a call*	95%	95.5%

* The objective is to serve clients within 180 seconds for 95 percent of calls.

Managing the CPP

COLLECTING AND RECORDING CONTRIBUTIONS

Contributions to the CPP are paid on earnings between a minimum and a maximum amount. The minimum (which remains constant) is $3,500 and the maximum is adjusted annually to reflect the growth in the average Canadian industrial wage. The maximum amount of pensionable earnings as of January 1, 2005, was $41,100 (up from $40,500 in 2004). Contributions stop once a contributor reaches the age of 70 or begins to receive a CPP retirement pension or disability benefit.

The contribution rates for 2005 are 4.95 percent for employees and 4.95 percent for employers. People who are self-employed pay both portions, for a total of 9.9 percent. Employers and employees make approximately 94 percent of contributions; the remaining 6 percent comes from the self-employed.

All CPP contributions are remitted to the Canada Revenue Agency (CRA). In 2004-05, contributions amounted to $28.9 billion.

CRA also assesses and verifies earnings and contributions, advises employers and employees of their rights and responsibilities, conducts audits, and reconciles reports and T4 slips. To verify that contribution requirements are being met, CRA applies a compliance and enforcement process that can vary from a computerized data match to an on-site audit. There are approximately 1.5 million existing employer accounts. During 2004-05, CRA conducted 53,438 audits, concentrating on files with irregularities.

OVERPAYMENT OF BENEFITS

Consistent with its mandate to manage the CPP effectively, the Department has procedures in place to detect benefit overpayments. During 2004-05, overpayments totaling $46 million were detected. Of this amount, $41 million were recovered and remission was granted on debts totaling $5 million.

CHANGES ANNOUNCED IN BUDGET 2004

In 2004, the rules governing contributions to the Canada Pension Plan were amended. They now allow a new employer who immediately succeeds another as a result of a change in business structure, to take into account the contributions the predecessor employer made for that same employee when determining amounts due. This change was extended to situations where self-employed individuals become employees of a corporation controlled by them or vice versa. The new rules apply for every year after 2003.

Before this change, when a business was restructured—notably as a result of a winding up and immediate reconstitution under a different legal structure (e.g., where a limited partnership is reconstituted as a corporation) or the acquisition of a major portion of the employer's property or of a distinct part of the employer's business (e.g., a distinct division of a business is sold to another enterprise)—employees were treated as if they had new employers. Employers were required to begin withholding CPP contributions anew and they could not take into account the contributions withheld at source by the previous employer—even if there had been no interruption of service by the employee.

Other amendments clarify the annual employers' contributions amount required under the Act and specify that only amounts remitted in excess may be refunded to the employer.

These changes will ensure harmonization of contribution requirements between the Canada Pension Plan and the Quebec Pension Plan. Further information about these changes can be obtained by contacting the Canada Revenue Agency at 1 800 959-5525.

ADMINISTRATIVE COSTS

In 2004-05, it cost approximately $386 million to administer the CPP, with SDC accounting for the largest portion — $263 million (see Table 3 below). CRA required approximately $96 million and Public Works and Government Services Canada (PWGSC) some $16 million, for services to the CPP. The Office of the Superintendent of Financial Institutions (OSFI), where the Office of the Chief Actuary is housed, and the Department of Finance incurred administrative costs of about $1.3 million and $388,000, respectively.

Since the administrative costs of the CPP Investment Board are drawn from the Board's investment income, they are reported in that organization's annual report. This is consistent with the arm's-length administration of the Board. In 2004-05, the CPP Investment Board reported $52.5 million in operating expenses and external investment management fees.

CPP administrative expenses in 2004-05 represent 1.62 percent of the $23.8 billion in benefits paid. This ratio compares very favourably with that of other pension plans. CPP administrative costs also compare favourably with those of RRSPs. Table 3 presents the CPP's administrative expenditures for the last three years.

TABLE 3 – CPP ADMINISTRATIVE COSTS 2002-03 TO 2004-05

	Expenditures (in $ thousands)		
Department/Agency	**2002-03**	**2003-04**	**2004-05**
SDC (formerly included with Human Resources Development Canada (HRDC))			$263,100
Human Resources and Skills Development Canada (HRSDC) – (formerly included with HRDC)*			9,306
Former HRDC	$327,964	$308,923	
CRA	80,229	85,258	96,484
PWGSC	12,823	14,693	15,821
OSFI	690	1,038	1,318
Finance Canada	495	425	388
Total	$422,201	$410,337	$386,417

* This reference is to the Department prior to merging with Social Development Canada. See the note on the inside page of this report for more information.

Looking to the Future

Some 302,000 new CPP applications are received each year and a significant increase is expected as our population ages. The challenge will be to improve service delivery to ensure that Canadians continue to receive timely, accurate and client-focused service. Long-term initiatives aimed at meeting that challenge are now underway.

CPP ONLINE

CPP Online supports the objectives of the federal Government On-Line (GOL) initiative and the commitment to provide Canadians with full electronic access to key federal information and services by 2005. CPP Online initiatives include the implementation of a web-based system that allows a wider range of inquiries and client transactions online and provides more integrated information on related benefits. The importance of strengthening our technological infrastructure is clear, especially since the fastest-growing group of Internet users is the senior population.

The Department has made it a priority to update the systems that help deliver benefits. Evolving over the next four years, the systems will support better decision making by improving the information available to management, clients and staff through faster and more up-to-date technology. The improvements will further reduce the paper burden and the complexity of the application process.

Putting CPP information online is a multi-year project designed to provide Canadians with online access to information, data, and services essential to income security and retirement planning. A comprehensive review of legislation, regulations, policies, and procedures will lay the groundwork for an innovative, leading-edge approach to online services and their policy and program context.

ONLINE SERVICES

By 2007, the Department will offer, in a secure environment, a number of online service options to allow access to information and services that are essential to income security and retirement. These services will include:

View and update personal information
In 2005, CPP clients obtained secure online access to their personal information. Using this service, they can view and update their mailing address and direct deposit information, and view their monthly payment amount. Enhancements will continue to be made, allowing more information to be viewed and updated in coming years.

Streamlined and automated CPP Statement of Contributions
CPP contributors can now submit an online request to receive a copy of their Statement of Contributions by mail. In 2005, they were able to view Statement of Contributions information online.

Tax information slips online
Since 2004, CPP clients have been able to view their CPP T4 slips online, starting with those for the 2003 taxation year. They also have the option to choose to use the online service to access their T4 slips in the future instead of having them sent by mail.

The Department continues to develop its capacity to deliver services online and move from a paper-based organization to an electronically-based organization.

SIMPLIFYING THE APPLICATION PROCESS

Simplifying the application process for the CPP retirement pension is part of the Department's planned service delivery improvements. The goal is to make the application process easier for clients through streamlined, client-driven and more effective services.

Making it easier to apply for the CPP retirement pension will be the first step in building a modern service system that is based on Canadians' needs and expectations. It will allow the use of alternative sources for proof of date of birth. As part of this initiative, services are being introduced that allow clients to apply for benefits online.

Since July 2003, a simplified CPP retirement application has been available for clients to fill out online. In March 2004, simplified OAS applications were also made available online. While clients could fill out these forms on the computer, they had to be printed, signed and mailed to SDC along with proof of birth. In 2005, SDC removed the requirement for the majority of clients to provide documentary proof of birth when the client's age and identity can be validated with the Social Insurance Register electronically.

In March 2004, SDC launched its first benefit application form that can be submitted over the Internet. Clients are now able to fill out a CPP retirement pension application online and submit it electronically. To complete the application process, clients must print, sign and mail the Signature Page along with their proof of birth. When client authentication enhancements are completed, clients will be able to sign their applications electronically.

REACHING ALL CANADIANS

Public pension programs help millions of people in Canada every day. The Department's primary objective is that every Canadian will receive the benefits to which he or she is entitled under its programs.

There has been a dramatic decline in the low income rate among Canadian seniors in recent decades. This is due in large part to the existence of public pensions such as the CPP.

Over the past several years, the Department has made a concerted effort to tell Canadians what they can expect from their public pensions and how they should prepare for their own retirement. Striving to communicate as directly as possible, the CPP will continue improving and personalizing its programs to reach its clients.

The Internet has a tremendous ability to reach Canadians. Social Development Canada led the development of a cross-departmental website called Canada Benefits (**www.canadabenefits.gc.ca**). The site's mandate is to provide central access to government-wide benefit programs and services for individuals.

The Canada Benefits site provides access to federal, provincial and territorial programs and services. These include, among others, public pensions, employment insurance benefits, and housing grants. The award-winning website supports the "citizen-first" principle—where information is organized according to the needs of Canadians and not the structures of government. For example, an interactive tool called the "Benefits Finder" provides citizens with a listing of programs and services relevant to their circumstances.

Since its update in January 2003, the Canada Benefits site has experienced significant success, receiving an average of 2,000 visitors every day. Through the Canada Benefits site and other means of communication, SDC was able to reach more Canadians than ever. Based on the firm conviction that all Canadians deserve financial security, the Department strives to make them aware of the benefits available and helps them obtain those to which they are entitled.

Canada Pension Plan

Financial Statements

for the year ended March 31, 2005

Management's responsibility for financial statements

The financial statements of the Canada Pension Plan have been prepared by management of Social Development Canada in accordance with the Canadian generally accepted accounting principles for the public sector.

Management is responsible for the integrity and objectivity of the data in these financial statements, including the amounts which must, of necessity, be based on best estimates and judgements. The financial information presented throughout the Annual Report is consistent with the financial statements.

In support of its responsibilities, management has developed and maintains systems of internal control and supporting procedures. They are designed to provide reasonable assurance that assets are safeguarded, recorded and properly maintained and transactions are properly authorized and are in accordance with the *Canada Pension Plan* and *Financial Administration Act* and accompanying regulations. These controls include the establishment of an organizational structure that provides a well defined division of responsibilities and accountability, the selection and training of qualified staff, and the communication of policies and guidelines throughout the organization. Internal controls are reviewed and evaluated by both internal and external auditors in accordance with its respective audits. Management also reviews the recommendations of its internal and external auditors for improvements in internal controls.

The Auditor General of Canada, the external auditor of the Canada Pension Plan, has conducted an independent audit of the financial statements in accordance with Canadian generally accepted auditing standards and has reported to the Minister of Social Development.

David Baxter
Comptroller
Social Development Canada

Nicole Jauvin
Deputy Minister
Social Development Canada

August 25, 2005

Auditor General of Canada
Vérificatrice générale du Canada

AUDITOR'S REPORT

To the Minister of Social Development

I have audited the statement of net assets of the Canada Pension Plan as at March 31, 2005 and the statements of changes in net assets and cash flow for the year then ended. These financial statements are the responsibility of the management of Social Development Canada. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audit in accordance with Canadian generally accepted auditing standards. Those standards require that I plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In my opinion, these financial statements present fairly, in all material respects, the financial position of the Canada Pension Plan as at March 31, 2005 and the changes in its net assets and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

Sheila Fraser

Sheila Fraser, FCA
Auditor General of Canada

Ottawa, Canada
August 25, 2005

Statement of Net Assets
as at March 31

	2005	2004
		Restated (Note 3)
	(in millions of dollars)	
Assets		
Investments		
CPP Investment Fund – at fair value (Note 4)		
Provincial and Territorial bonds	**16,693**	25,397
Canada bonds	**2,641**	4,070
CPP Investment Board – at fair value (Note 6)	**58,722**	32,894
Cash		
Deposit with Receiver General for Canada	**2,771**	7,483
Receivables		
Contributions	**2,278**	1,946
Accrued Interest	**550**	862
Régime des rentes du Québec	**30**	28
Beneficiaries (Note 7)	**36**	36
	83,721	72,716
Liabilities		
Accounts payable	**32**	55
Accrued pensions and benefits	**52**	51
Taxes due to Canada Customs and Revenue Agency	**84**	-
CPP Investment Board's liabilities, net of its other assets	**142**	99
	310	205
Net Assets	**83,411**	72,511
Net Assets, represented by:		
Canada Pension Plan Investment Fund	**19,334**	29,467
Accumulated transfers to CPP Investment Board (Note 5)	**50,627**	29,824
Accumulated net gain from Investment Board's operations	**7,953**	2,971
Canada Pension Plan Account (Note 8)	**2,771**	7,483
CPP receivables, net of liabilities	**2,726**	2,766
Net Assets	**83,411**	72,511

Contingencies (note 12)
The accompanying notes are an integral part of these financial statements.

Approved by Social Development Canada:

David Baxter
Comptroller
Social Development Canada

Nicole Jauvin
Deputy Minister
Social Development Canada

Statement of Changes in Net Assets
for the year ended March 31

	2005	2004
		Restated (Note 3)
		(in millions of dollars)
Net assets, beginning of year	**72,511**	57,251
Increase in assets		
Contributions (Note 9)	**28,941**	28,029
Investment income (Note 10)	**6,108**	10,248
	35,049	38,277
Decrease in assets		
Pensions and benefits		
Retirement	**16,822**	15,880
Survivors	**3,333**	3,194
Disability	**2,926**	2,850
Disabled contributor's child	**258**	257
Death	**249**	255
Orphan	**216**	213
Net overpayments	**(41)**	(42)
	23,763	22,607
Administration costs (Note 11)	**386**	410
	24,149	23,017
Increase in net assets	**10,900**	15,260
Net assets, end of year	**83,411**	72,511

The accompanying notes are an integral part of these financial statements.

Statement of Cash Flow
for the year ended March 31

	2005	2004
	(in millions of dollars)	
Cash Flow Provided by Operating Activities		
Cash Receipts:		
Contributions	**28,609**	27,714
Interest from CPP Investment Fund	**2,071**	2,572
Interest on Deposit with Receiver General for Canada	**135**	188
Recoveries from Régime des rentes du Québec	**265**	288
Recoveries from beneficiaries	**41**	37
	31,121	30,799
Cash Payments:		
Pensions and benefits	**(23,718)**	(22,634)
Repayments to Régime des rentes du Québec	**(268)**	(251)
Administration costs	**(409)**	(430)
	(24,395)	(23,315)
	6,726	7,484
Cash Flow Used in Investing Activities		
Transfers to CPP Investment Board		
(including interest collected on its behalf)	**(18,668)**	(8,134)
Transfers from CPP Investment Board	**6,669**	-
Disposals of bonds net of reinvestments – CPP Investment Fund	**561**	1,040
	(11,438)	(7,094)
Net Increase (Decrease) in the Deposit with Receiver General for Canada	**(4,712)**	390
Deposit with Receiver General for Canada, beginning of year	**7,483**	7,093
Deposit with Receiver General for Canada, end of year	**2,771**	7,483

The accompanying notes are an integral part of these financial statements.

Notes to financial statements March 31, 2005

1. DESCRIPTION OF THE CANADA PENSION PLAN

a) Description of the CPP

The Canada Pension Plan (CPP) is a federal/provincial plan established by an Act of Parliament in 1965.

The CPP began operations in 1966. It is a compulsory and contributory social insurance program operating in all parts of Canada, except Quebec, which operates the Régime des rentes du Québec, a comparable program. The Plan's objective is to provide a measure of protection to workers and their families against the loss of earnings due to retirement, disability or death.

The Minister of Social Development is responsible for the administration of the *Canada Pension Plan* (the CPP Act); the Minister of National Revenue is responsible for collecting contributions. The Minister of Finance and his provincial counterparts are reponsible for setting CPP contribution rates, pension and benefit levels and funding policy.

The financial activities of the Canada Pension Plan are recorded in the CPP Account (Note 8). The plan assets are held by the CPP Investment Fund (Note 4) and the CPP Investment Board (Note 6). The financial transactions affecting the Account and the Investment Fund are governed by the CPP Act and regulations. The Investment Board's transactions are governed by the *Canada Pension Plan Investment Board Act* and the accompanying regulations.

As stated in the CPP Act, changes to this Act require the approval of at least two-thirds of the provinces having, in the aggregate, not less than two-thirds of the population of all included provinces.

b) Financing

CPP is financed by contributions and investment returns. Employers and employees pay contributions equally to CPP. Self-employed workers pay the full amount.

CPP was designed initially to be financed on a pay-as-you-go basis, which means that the Plan would operate on a current basis with pensions and benefits being paid out of current contributions. With changes made to the Act in 1997, CPP is now intended to be funded on a "steady-state" basis—that is, combined contributions of 9.9% of pensionable earnings will provide a capitalization level of 25% of the Plan's liability within about 15 years.

From 1966 to 1986, the combined employer-employee contribution rate remained at 3.6% of pensionable earnings. In 1987, it was raised to 3.8% and increased yearly by 0.2% to reach 5.6% in 1996. In the years 1997 to 2003, the combined contribution rate was increased annually to reach 9.9%. The maximum combined contribution for 2005 was $3,722 (2004 – $3,663).

The CPP Act provides that an actuarial report shall be prepared every three years for purposes of the review of the financial state of the CPP by the Minister of Finance and his provincial counterparts. The *Twenty-first Actuarial Report* of the Chief Actuary of the Office of the Superintendent of Financial Institutions was tabled on December 8, 2004. The CPP is financially sound and the 9.9% combined employee-employer contribution rate reached in 2003 is expected to be sufficient to sustain the Plan in the face of an aging population.

A number of assumptions such as long term rate of return on assets, inflation rate, mortality rates, increase in salary and benefit rates, among other things, were used in the 21st CPP actuarial report. These assumptions reflect best estimates of future economic and demographic events. The next actuarial report as at December 31, 2006 is expected to be completed by December 2007.

c) Net assets of the Plan

The net assets of the Plan are composed of the deposit with the Receiver General for Canada and investments held by the CPP Investment Fund and the CPP Investment Board. They represent funds accumulated for the payment of pensions, benefits and administration costs. This amount does not cover the actuarial present value of accrued pensions and benefits. As at March 31, 2005, the net assets of the Plan are of $83 billion (2004 – $72.5 billion). This amount represents approximately 3.5 times the total of pensions and benefits in 2005 (2004 – 3.2 times). According to the 21st Actuarial Report, this is expected to grow to 5.6 times by 2021.

d) Pensions and benefits

Retirement pensions – A retirement pension is payable to each contributor at age 60 or older, according to the provisions of the Act. The monthly amount is equal to 25% of the contributor's average monthly pensionable earnings during the pensionable period. The amount may be reduced or increased depending upon whether the contributor applies for a retirement pension before or after age 65. This adjustment cannot exceed 30%. The maximum new monthly pension payable at age 65 in 2005 is $828.75 (2004 – $814.17).

Disability benefits – A disability benefit is payable to a contributor who is disabled, according to the provisions of the Act. The amount of the disability benefit to be paid includes a flat-rate portion and an amount equal to 75% of the earned retirement pension. The maximum new monthly disability benefit in 2005 is $1,010.23 (2004 – $992.80).

Survivor's benefits – A survivor's benefit is payable to the spouse or common-law partner (the beneficiary) of a deceased contributor, according to the provisions of the Act. For a beneficiary under the age of 65, the benefit consists of a flat-rate portion and an amount equal to 37.5% of the deceased contributor's earned retirement pension. A beneficiary between the ages of 35 and 45 who is not disabled or who has

no dependent children receives reduced benefits. For beneficiaries aged 65 and over, the benefit is equal to 60% of the retirement pension granted to the deceased contributor. The maximum new monthly benefit payable to a beneficiary in 2005 is $497.25 (2004 – $488.50).

Disabled contributor's child and orphan benefits – According to the provisions of the Act, each child of a contributor who is receiving disability benefits or who died is entitled to a benefit as long as the child is under the age of 18, or is between the ages of 18 and 25 and attending school full-time. The flat-rate monthly benefit in 2005 is $195.96 (2004 – $192.68).

Death benefits – According to the provisions of the Act, a death benefit is a one-time payment to, or on behalf of, the estate of a contributor. The benefit amounts either to 10% of the maximum pensionable earnings in the year of death or six times the monthly retirement pension granted to the deceased contributor, whichever is less. The maximum death benefit in 2005 is $2,500 (2004 – $2,500).

Pensions and benefits indexation – As required by the Act, pensions and benefits are indexed annually based on the Consumer Price Index for Canada. The rate of indexation for 2005 is 1.7% (2004 – 3.2%).

2. SIGNIFICANT ACCOUNTING POLICIES

a) Basis of presentation

These financial statements present the financial position, the changes in net assets and the cash flows of the Canada Pension Plan. They include the financial position of the CPP Investment Board and the results of its operations. These financial statements are prepared in accordance with Canadian generally accepted accounting principles for public sector entities and conform to the disclosure and accounting requirements of the CPP Act.

These financial statements do not provide information on the actuarial estimates required to meet future obligations of the CPP since the CPP Act does not require that the pensions and benefits be pre-funded. The CPP, which is under joint control of the Government of Canada and participating provinces, is not considered to be part of the reporting entity of the Government of Canada. Accordingly, its financial activities are not consolidated with those of the Government.

b) Valuation of investments

Investments are stated at fair value.

Fair value is the amount of the consideration that would be agreed upon in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act.

Bonds held by the CPP Investment Fund and the CPP Investment Board – The fair value is determined by calculating the present value of bonds' projected cash flows. The discount rate used is based as appropriate on the provincial, territorial or government of Canada market rates. The fair value includes a further discount for the non-marketable, non-transferable, and rollover characteristics of the bonds.

Bonds issued by the provincial and territorial governments can be redeemed prior to maturity at the option of these governments or renewed for another 20 years. There are distinct calculation methods for bonds early redemption or renewal that do not take into consideration the non-marketable and non-transferable characteristics.

Any early redemption or renewal could therefore result in transactions at amounts that differ from the recorded fair value of the bonds.

Other investments held by the CPP Investment Board – The fair value is determined as follows: quoted market prices for publicly traded equities and unit values for pooled funds. Unit values reflect the quoted market prices of the underlying securities.

In the case of private equity investments, where quoted market prices are not available, fair value is determined annually, commencing after the first year of ownership, based on carrying values and other relevant information reported by external managers of the limited partnerships or funds in which the investments are made. These carrying values are determined by the external managers using accepted industry valuation methods. These methods include considerations such as earnings multiples of comparable publicly traded companies, discounted cash flows and third party transactions, or other events which suggest material impairment or improvement in the value of the investment. On a quarterly basis, when, there is evidence of a significant change in fair value, the valuation is adjusted, as appropriate. In the first year of ownership, cost is generally considered to be an appropriate estimate of fair value for private equity investments and infrastructure funds, unless there is an indication of permanent impairment of value.

The fair value of private market investments in real estate properties is determined annually, commencing after the first year of ownership, using accepted industry valuation methods, such as discounted cash flows and comparable purchase and sales transactions. In the first year of ownership, cost is generally considered to be an appropriate estimate for fair value of real estate unless there is an indication of permanent impairment of value. Debt on real estate investments is valued using discounted cash flows based on current market yields for instruments with similar characteristics.

Fair value for over-the-counter derivatives such as swaps and forward contracts is determined based on market prices for underlying assets. Fair value of exchange-traded futures is based on quoted market prices.

Money market securities are recorded at cost which, together with accrued interest income, approximates fair value.

c) Contributions

Contributions include CPP contributions earned for the year. The Canada Customs and Revenue Agency collects contributions and measures them using the assessment of tax returns. In determining the amount of contributions earned for the year, the Agency considers cash received and contributions assessed, and makes an estimate for contributions related to tax returns not yet assessed. This estimate is subject to review and adjustments. Adjustments, if any, are recorded as contributions in the year they are known.

d) Investment income recognition

CPP Investment Fund income is recorded on the accrual basis and includes unrealized gains and losses on bonds held at the end of the year.

CPP Investment Board's net income from operations represents the Investment Board's investment income, less investment and administrative expenses. Investment income is recorded on the accrual basis and includes realized gains and losses on disposal of investments, unrealized gains and losses on investments held at the end of the year, dividend income (recognized on ex-dividend date), interest income, distributions from partnerships and trusts, and net operating income from private market real estate investments.

Realized gains and losses on investments sold during the year represent the difference between sale proceeds and cost, less related costs of disposition. Unrealized gains and losses represent in the difference between the fair value and cost of investments. The current year unrealized gains and losses represent the year-over-year change in this difference.

e) Translation of foreign currencies

Transactions in foreign currencies are recorded at the rates of exchange prevailing on the transaction date. Investments denominated in foreign currencies and held at the year end are translated at exchange rates in effect at the year end date. The resulting realized and unrealized gains and losses are included in investment income.

f) Pensions and benefits

Pensions and benefits are recorded when payable.

g) Net overpayments

Net overpayments are composed of overpayments of pensions and benefits that were established during the year less remissions of debts granted.

h) Administration costs

Administration costs are recorded in the year to which they relate.

i) Use of estimates

The preparation of financial statements in accordance with the Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities as at the date of the financial statements and revenue and expenses for the year. Actual results could differ from these estimates. The most significant estimates are related to contributions, allowance for doubtful accounts, the fair value of the bonds held by the CPP Investment Fund and the fair value of investments held by the CPP Investment Board.

3. IMPLEMENTATION OF THE LEGISLATIVE AMENDMENT

Legislation to amend the Canada Pension Plan and the *Canada Pension Plan Investment Board Act* came into force on April 1, 2004. The amended legislation and a related administrative agreement provide for the transfer of CPP assets, that were administered by the federal government, to the CPP Investment Board, beginning in 2004. These assets consist of the bonds held by the CPP Investment Fund and a portion of the Deposit with the Receiver General of Canada. The CPP Investment Board, and the federal government have signed an agreement governing the process for the transfer of the assets.

The bonds will be transferred to the CPP Investment Board over a three year period beginning in May 2004. Funds on Deposit with the Receiver General for Canada will be transferred over a period of twelve months beginning in September 2004.

The amended legislation and related administrative agreement also provide for the weekly transfer of any amounts held in the Canada Pension Plan Account to the CPP Investment Board that exceed the immediate obligations of the CPP.

4. INVESTMENTS HELD BY THE CPP INVESTMENT FUND

The Canada Pension Plan Investment Fund was established in the accounts of Canada by the CPP Act to record the Plan's investments in bonds of the provinces, territories and Canada. The CPP Investment Fund's bond portfolio is administered by the federal Department of Finance.

Until the end of 1997, the investments in provincial, territorial and federal government bonds were made with the cash on hand in excess of the Plan's forecast three-month operating requirement. These bonds were not marketable and had a 20-year term (or less) as fixed by the Minister of Finance on the recommendation of the Chief Actuary of the Office of the Superintendent of Financial Institutions. The interest rate on the bonds was determined by the Minister of Finance based on the average yield to maturity of all outstanding Government of Canada obligations with terms of 20 years or more. When these bonds matured, funds not required for payment of pensions and benefits were re-invested in new bonds.

Since 1998, a maturing provincial or territorial bond may be re-invested in a new bond only once for a term of 20 years, if both the issuer asks to do so and the operating balance is sufficient to pay current pensions and benefits. Excess funds not re-invested are transferred to the CPP Investment Board.

The re-invested bonds remain not marketable and bear interest at a rate fixed by the Minister of Finance. The interest rate is substantially the same rate that the province would pay if it were to borrow the same amount for the same term through the issuance of a bond on the public capital markets. Interest earned on the investments is paid semi-annually to the CPP Account.

During the year, all disposals of bonds were made, at maturity date, at face value. The bonds are redeemable in whole or in part before maturity. Since January 31, 2001, the provinces and territories are permitted to redeem their bonds held by the CPP Investment Fund prior to their maturity at a value equivalent to market value. No bonds were redeemed by the provinces and the territories prior to maturity during the year ended March 31, 2005 (2004 – none).

In accordance with the amended legislation and the related administrative agreement, the bonds held by the CPP Investment Fund will be transferred to the CPP Investment Board on a monthly basis as explained in note 3. As at March 31, 2005, 11/36th of the Investment Fund was transferred (approximately $8.8 billion).

The bonds held by the CPP Investment Fund are exposed to interest rate risk. Interest rate risk refers to the risk of an adverse change in the fair value of the bonds as a result of an unfavourable movement in market interest rates.

The following table provides information on disposals, re-investments, unrealized gains/ (losses) of bonds as well as bonds transferred to the CPP Investment Board and the remaining balance held by the CPP Investment Fund:

CPP Investment Fund

(in millions of dollars)

	March 31, 2004 at cost	Disposals	Re-Investments	**March 31, 2005 at cost**	**March 31, 2005 at fair value**	March 31, 2004 at fair value
Newfoundland	633	51	51	**633**	**698**	714
Prince Edward Island	140	11	11	**140**	**155**	159
Nova Scotia	1,079	86	86	**1,079**	**1,196**	1,232
New Brunswick	834	67	67	**834**	**921**	940
Quebec	96	5	5	**96**	**108**	111
Ontario	10,233	1,133	1,133	**10,233**	**11,377**	11,687
Manitoba	1,002	119	–	**883**	**997**	1,167
Saskatchewan	1,082	104	–	**978**	**1,095**	1,241
Alberta	3,144	339	78	**2,883**	**3,253**	3,661
British Columbia	3,934	355	199	**3,778**	**4,234**	4,481
Yukon Territory	4	–	–	**4**	**4**	4
	22,181	2,266	1,626	**21,541**	**24,038**	25,397
Canada	3,352	17	–	**3,335**	**3,803**	4,070
	25,533	2,283	1,626	**24,876**	**27,841**	29,467
CPP Investment Board's share	*0	(237)	(141)	**(7,601)**	**(8,507)**	–
CPP's share	25,533	2,046	1,485	**17,275**	**19,334**	29,467

** CPP transferred to CPP Investment Board bonds with a cost of $7,697 during the year ending March 31, 2005.*

In order to reflect the non-marketable and non-transferable characteristics of the bonds, an additional discount factor has been used in determining the fair value. The use of this additional discount factor reduced the reported fair value by $1.19 billion ($1.26 billion in 2004). The following schedule presents the fair value of the bonds by maturity dates and the average annual rate of return on bonds currently held based on current effective yields for similar type bonds.

	2005 Investments at fair value	2005 Effective yield	2004 Investments at fair value	2004 Effective yield
	(in millions of dollars)			
Investments maturing				
Within 1 year	1,620	5.26%	2,254	5.31%
1 – 5 years	7,268	5.01%	10,812	4.62%
Over 5 years	10,446	5.54%	16,401	5.35%
Total – Investments	19,334		29,467	
Average effective yield on investments	5.32%		5.08%	

5. ACCUMULATED TRANSFERS TO THE CPP INVESTMENT BOARD

	2005	2004
	(in millions of dollars)	
Accumulated transfers, beginning of year	29,824	21,690
Transfers of bonds titles and accrued interest	*8,804	–
Transfers of funds to CPPIB	18,668	8,134
Transfers of funds from CPPIB	(6,669)	–
	50,627	29,824

** Based on fair market value at the time of transfer.*

6. INVESTMENTS HELD BY THE CPP INVESTMENT BOARD

The Canada Pension Plan Investment Board (CPPIB) was established by an Act of Parliament in 1997. The *Canada Pension Plan Investment Board Act* came into force on April 1, 1998. The purpose of the Board is to invest the funds transferred by the CPP in a diversified portfolio of investments.

The Board is designed to operate at arm's length from the government. It is required to be accountable to the public, Parliament (through the federal Minister of Finance), and the provinces and provides regular reports of its activities and the results achieved.

The following schedule provides information on the Board's investments as at March 31:

	2005	2004
	(in millions of dollars)	
Canadian equities, at fair value		
Public Markets	**21,044**	18,046
Private Markets	**512**	282
	21,556	18,328
Non-Canadian equities, at fair value		
Public Markets	**12,646**	7,552
Private Markets	**2,394**	1,530
	15,040	9,082
Total Equities		
(Cost 2005 – $32,141; 2004 – $25,034)	**36,596**	27,410
Real Return Assets		
Public markets real estate	**384**	350
Private markets real estate	**638**	432
Private markets infrastructure	**230**	22
Total Real Return Assets (Cost 2005 – $1,222; 2004 – $829)	**1,252**	804
Nominal Fixed Income		
Bonds transferred from the CPP Investment Fund	**8,507**	–
Money Market Securities (Cost 2005 – $20,614; 2004 – $4,784)	**12,067**	4,777
Total Nominal Fixed Income	**20,574**	4,777
Investment Receivables (Cost 2005 – $340; 2004 – $68)	**339**	68
Derivatives Receivable	**240**	35
Investments Liabilities (Cost 2005 – $234; 2004 – $170)	**(242)**	(171)
Derivatives Liabilities	**(37)**	(29)
Total Net Investments	**58,722**	32,894

The CPP Investment Board has established investment policies which set out the manner in which assets shall be invested. In determining its target asset weights, the CPP Investment Board takes into consideration certain assets of the CPP which are held outside the CPP Investment Board.

Private equity investments

Private equity investments are generally made by buying interests in limited partnerships with a typical term of 10 years. The private equity limited partnership's underlying investments represent equity ownerships or investments with the risk and return characteristics of equity.

The CPP Investment Board advances capital to the limited partnerships, a portion of which, commonly referred to as management fees, is used by general partners to select and provide ongoing management support to the underlying companies. Management fees generally vary between 1 per cent to 2 per cent of the total amount committed to the limited partnerships, and are included as part of the CPP Investment Board's cost of the investments. During the year ended March 31, 2005, management fees totalling $70 million (2004 – $64 million) were included in the capital advanced to the limited partnerships and recorded as part of the cost of the investment. As discussed more fully in note 2b), the carrying values of these investments are reviewed at least annually and any resulting adjustments are reflected as unrealized gains or losses in investments income.

Real return assets

As at March 31, 2005, investments total $780,448,000 in real estate investments (March 31, 2004 – $611,531,000) and $230,125,000 in private market infrastructure (March 31, 2004 – $22,013,000).

The CPP Invesment Board obtains exposure to real estate through investments in publicly traded securities and privately held real estate. Private real estate investments are held by a subsidiary and are managed on behalf of the CPP Investment Board by external advisors and managers through co-ownership arrangements. As at March 31, 2005, the subsidiary's share of these investments includes assets of $638,200,000 (March 31, 2004 – $431,848,000) and $241,752,000 of liabilities related to mortgage debt (March 31, 2004 – $170,797,000), with a weighted average fixed interest rate of 7.64 per cent and terms to maturity of two to 16 years.

The CPP investment Board currently uses limited partnership arrangements to invest in infrastructure. The underlying investments of these limited partnerships represent equity ownerships in entities that invest in infrastructure assets which are expected to provide predictable cash flows. Management fees for infrastructure investments are treated similar to private equity management fees as discussed in the previous section. During the year ended March 31, 2005, management fees included in the capital advanced to the limited partnerships were $1,777,000 (2004 – $214,000).

Derivative Contracts

A derivative is a financial contract, the value of which is derived from the value of underlying assets, indexes, interest rates or currency exchange rates.

The CPP Investment Board uses derivatives primarily to replicate the return of Canadian and Non-Canadian equities and to manage asset weights and currency exposure. The CPP Investment Board has

equity swaps outstanding to exchange money market interest payments for equity returns. The CPP Investment Board also uses exchange-traded futures contracts and foreign exchange forwards to either buy or sell a specified index or currency at a specificied price and date in the future. Futures are used to achieve the desired market exposure to equity markets, and foreign exchange forwards to manage currency exposure.

All derivative contracts have a term to maturity of one year or less. Notional amounts of derivative contracts are used to compute the cash flows and for determining the fair value of the contracts. Notional amounts are not recorded as assets or liabilities on CPP's Statement of net assets.

The notional amounts and fair value of derivative contracts held as at March 31 are as follows:

	2005		2004	
	(in millions of dollars)			
	Notional Amount	**Fair Value**	Notional Amount	Fair Value
Equity swaps	**5,918**	**206**	4,034	9
Equity futures	**6,061**	**(6)**	448	(3)
Foreign exchange forwards	**2,093**	**3**	–	–
Total	14,072	**203**	4,482	6

Securities Lending

The CPP Investment Board participates in a securities lending program to enhance portfolio returns. Credit risk associated with the securities lending program is mitigated by requiring the borrower to provide daily collateral in the form of readily marketable investments of greater market value than the securities loaned. As at March 31, 2005, the CPP Investment Board's investments include loaned securities with an estimated fair value of $1.4 billion (2004 – 721 million). The fair value of collateral received in respect of these loans is $1.5 billion (2004 – 758 million).

CPP Investment Board's Investment Risks

Invesments, investments receivables and investments liabilities may be exposed to one or more of the following risks:

Currency Risk

The CPP Investment Board is exposed to currency risk through holdings of investments, investment receivables and investment liabilities in various currencies. The net underlying currency exposures, after allocating foreign currency derivatives, as at March 31, 2005 are as follows:

	2005		2004	
	(in millions of dollars)			
	Net Exposure	% of Total	Net Exposure	% of Total
Currency				
Canadian Dollar	$ 42,339	72	$ 23,280	71
United States Dollar	7,804	13	5,599	17
Euro	3,464	6	1,557	5
British Pound Sterling	2,086	3	932	3
Japanese Yen	1,256	2	698	2
Australian Dollar	462	1	137	–
Swiss Franc	340	1	349	1
Other	971	2	342	1
	$ 58,722	100	$ 32,894	100

Interest Rate Risk

Interest Rate Risk refers to the effect on the fair value of investments and liabilities due to fluctuations of interest rates. The fair value of the CPP Investment Board's bonds and mortgage debt is affected directly by changes in interest rates.

Market Risk

Market Risk is the risk that the value of an investment will be adversely affected by changes in market prices, whether those changes are caused by factors specific to individual investment or factors affecting all securities traded in the market. The CPP Investment Board mitigates market risk through diversification of its investment portfolio, based on asset and risk limits established in the investment policies.
Credit Risk

Credit Risk

The CPP Investment Board limits credit risk by dealing with counterparties that have a minimum credit rating of A or R-1 (short term) as determined by a recognized credit rating agency, where available, or as determined through an internal credit rating process. Credit exposure is limited to maximum amounts as specified in the investment policies.

Liquidity Risk

The CPP Investment Board is exposed to liquidity risk through its responsibility for providing cash management services to the CPP. The CPP Investment Board mitigates liquidity risk through its unsecured credit facilities.

Commitments

The CPP Investment Board has committed to enter into investment transactions, which will be funded over the next several years in accordance with the agreed terms and conditions. As at March 31, 2005, these remaining commitments total $5.4 billion (2004 – $3.9 billion). As at March 31, 2005, the organisation has made lease commitments of $20 million (March 31, 2004 – $21 million) over the next nine years.

Other Information

The CPP Investment Board is exempt from Part I tax under paragraph 149 (1) (d) of the *Income Tax Act* (Canada) on the basis that all of the shares of the CPP Investment Board are owned by Her Majesty the Queen in right of Canada. The CPP Investment Board's subsidiaries are exempt from Part I tax under paragraph 149 (1) (d.2) of the *Income Tax Act* (Canada) on the basis that all of the shares of the subsidiaries are owned by a corporation whose shares are owned by Her Majesty the Queen in right of Canada.

The CPP Investment Board's audited financial statements for the year ended March 31, 2005 are publicly available and provide details concerning the Board's investment policy, its investments and portfolio returns.

7. RECEIVABLES FROM BENEFICIARIES

	2005	2004
	(in millions of dollars)	
Balance of pensions and benefits overpayments	**82**	81
Allowance for doubtful accounts	**(46)**	(45)
	36	36

Social Development Canada has procedures to detect overpayments. During the year, overpayments totalling $46 million (2004 – $45 million) were established and remissions of debts totalling $5 million (2004 – $4 million) were granted. A further $41 million was recovered (2004 – $37 million).

8. CANADA PENSION PLAN ACCOUNT

The CPP Account was established in the accounts of Canada by the CPP Act, to record the contributions, interest, pensions, benefits and administration costs of the Plan. It also records the amounts transferred to or received from the CPP Investment Fund and the CPP Investment Board.

In accordance with the amended legislation and the related agreement, funds on deposit with the Receiver General for Canada will be transferred to the CPP Investment Board on a monthly basis as explained in Note 3. As at March 31, 2005, 7/12th of the funds to be transferred (approximately $3.8 billion) have been transferred.

As at March 31, 2005, the Deposit with the Receiver General for Canada is $2,771 million (2004 – $7,483 million).

9. CONTRIBUTIONS

Contributions for the year are measured by Canada Customs and Revenue Agency (CCRA) using the assessment of tax returns. In determining the amount of contributions earned for the year, the Agency considers cash received and contributions assessed and makes an estimate for contributions related to tax returns not yet assessed.

Actual results may differ from these estimates. Actual contribution amounts for calendar years 2004 and 2005 will only be known once CCRA has processed all employer's and self-employed workers' declarations of contributions for these years. An adjustment for the difference between actual and estimated contributions will be recorded in the fiscal year in which the adjustment is known.

10. INVESTMENT INCOME

	2005	2004
	(in millions of dollars)	
CPP Investment Fund income:		
Interest on bonds	**1,941**	2,500
Investment income (loss) on bonds	**(945)**	357
	996	2,857
Interest on deposit with the Receiver General for Canada at a weighted-average annual rate of 2.11% (2004-- 2.59%)	**129**	182
CPP Investment Board net income from operations:		
Net unrealized gains	**2,182**	6,050
Net realized gains	**1,762**	658
Investment income on bonds	**319**	–
Dividend Income	**737**	504
Other investment income	**35**	21
Investment and administrative expenses	**(52)**	(24)
	*** 4,983**	* 7,209
Investment Income	**6,108**	10,248

** Includes foreign exchange losses of $867.4 million (2004 – $392.6 million).*

11. ADMINISTRATION COSTS

	2005	2004
	(in millions of dollars)	
Pension and benefit delivery, accommodation and corporate services		
Social Development Canada	**263**	–
Human Resources and Skills Development Canada	**10**	–
Human Resources Development Canada	–	309
Collection of contributions (Canada Customs and Revenue Agency)	**96**	85
Cheque issue and computer services (Public Works and Government Services Canada)	**16**	15
Actuarial services (Office of the Superintendent of Financial Institutions)	**1**	1
	386	410

Administration costs of the CPP represent the cost of services received from a number of federal government departments and an agency. Those costs are based on estimated allocations of costs and are charged to the CPP in accordance with the memoranda of understanding. For the year ended March 31, 2005, pension and benefit delivery, accommodation and corporate services, formerly provided by HRDC, were provided by SDC and HRSDC following the creation of the two new departments.

12. CONTINGENCIES

At March 31, 2005, there were 8,331 (4,403 in 2004) appeals relating to the payment of CPP pensions and benefits. These contingencies are estimated at an amount of $33 million ($22 million in 2004). Any award made in favour of beneficiaries will be accounted for as an expense of the period in which the amount becomes determinable.

A class action was filed against the CPP for discrimination against survivors whose same-sex common-law partners died on or after April 17, 1985 and before January 1, 1998. On November 26, 2004, the Court of Appeal for Ontario ruled that eligible class members, whose partners died between April 17, 1985 and January 1, 1998, will be entitled to receive pension payments. On January 25, 2005, both the government and counsel for the class members sought leave to appeal to the Supreme Court of Canada. Both requests for leave were granted on June 23, 2005. At the time of the preparation of the financial statements the Supreme Court of Canada had not yet set a hearing date.

On July 12, 2005, the Ontario Superior Court endorsed the agreement of the Government of Canada and the counsel for the class members to pay interim Survivor's Pensions to class members who currently have an active and complete application with the department. Where the CPP eligibility criteria are met, the interim payment may have a maximum retroactive date of January 1st, 2003. In the event that the Supreme Court of Canada ultimately reverses the decisions of the lower courts, these interim payments would have to be reimbursed to the CPP. The ultimate contingency involved in this class action is still estimated at an amount between $71 and $132 million.

13. RELATED PARTY TRANSACTIONS

In addition to the transactions disclosed in the other notes to the financial statements, the CPP has $2,278 million (2004 – $1,946 million) of contributions receivable from the Canada Customs and Revenue Agency and accounts payable of $32 million (2004 – $55 million) to the Government of Canada for the administration of the Plan.

The CPP enters into transactions with the Government of Canada in the normal course of business at exchange value.

ANNUAL REPORT OF THE

Canada Pension Plan

2004-2005

Government of Canada Gouvernement du Canada

CPP 40 YEARS
1966-2006

ANNUAL REPORT OF THE

CANADA PENSION PLAN

2005–06

Canada

Annual Report of the Canada Pension Plan 2005-06

Fiscal Year 2005-06

ISPB-203-05-07E

As of February 2006, the legal names of the minister and department responsible for the Canada Pension Plan (CPP) are the Minister of Human Resources and Skills Development and the Department of Human Resources and Skills Development respectively. Operationally, the department is styled as Human Resources and Social Development Canada (HRSDC).

The names of the departments previously responsible for the CPP, namely Human Resources Development Canada (HRDC) and/or Social Development Canada (SDC), are used in this report in a historical context only.

This report is produced by Human Resources and Social Development Canada, in collaboration with: the Department of Finance, the Canada Revenue Agency, Public Works and Government Services Canada, and the Office of the Superintendent of Financial Institutions.

If you require additional copies of this report, it is available for printing at: **www.hrsdc.gc.ca**

Or you may contact:

Publications/Distribution Unit
HRSDC Communications Branch
140 Promenade du Portage
Place du Portage, Phase IV, Level 0
Gatineau, Québec K1A 0J9
Facsimile: 819-953-7260
E-mail: publications@hrsdc-rhdsc.gc.ca

Aussi disponible en français sous le titre *Rapport annuel du Régime de pensions du Canada 2005-2006.*

To give feedback on the Annual Report, see our form online at **www.hrsdc.gc.ca** under "Publications".

For more detailed information about subjects covered in this report, or about the Canada Pension Plan in general, please visit: **www.hrsdc.gc.ca**

If you have questions, please call (free of charge from Canada and the U.S.):

1 800 277-9914 (English)
1 800 277-9915 (French)
1 800 255-4786 (TTY)

Government of Canada Gouvernement du Canada

Her Excellency
The Governor General of Canada

May it please Your Excellency:

We have the pleasure of submitting the *Annual Report of the Canada Pension Plan* for the fiscal year 2005-06.

Respectfully,

James M. Flaherty
Minister of Finance

Monte Solberg
Minister of
Human Resources and Social Development

Canada

Table of Contents

This report on the Canada Pension Plan (CPP) consolidates input from all departments involved in the administration of the Plan: Social Development Canada (SDC), the Department of Finance, the Canada Revenue Agency (CRA), Public Works and Government Services Canada (PWGSC), the Office of the Superintendent of Financial Institutions (OSFI) and the CPP Investment Board (CPPIB).

Foreword THE CANADA PENSION PLAN – 40 YEARS STRONG!

For 40 years, the CPP has been contributing to the income security of Canadians. It is a vital part of Canada's social safety net and retirement income system.

In 1966, Canadians began contributing to the CPP and Quebec Pension Plan (QPP). The plans were created to provide a measure of income protection to Canadian workers and their families. They included monthly retirement pensions, benefits for people with disabilities, dependent children, survivors and a one-time lump-sum death benefit.

Changes made over the years better meet the needs of Canadians. These include:

- introduction of full annual cost-of-living indexation (1974);
- elimination of the difference in availability of survivor benefits to male and female contributors as well as to their surviving spouses and dependent children (1975);
- elimination of the retirement and employment-earnings test to receive a retirement pension at age 65 (1975);
- social security agreements with other countries that protect pensions for new Canadians and emigrants (1978);
- exclusion of zero or low earning periods while caring for a child under the age of seven (1978);
- flexibility in receiving an actuarially adjusted retirement pension as early as age 60 or as late as age 70 (1987);
- credit splitting between spouses in the event of divorce (1978) or separation (1987);
- continuation of survivor's pensions if the surviving spouse remarries (1987);
- sharing of retirement pensions between spouses (1987);
- availability, as defined by the *Indian Act*, for individuals working on reserve to make CPP contributions (1988);

- major reforms to the CPP to restore the long-term financial health of the plan by moving to a new and unique financing approach that provides for the fuller funding of benefits as they accrue to the individual (1998);
- creation of the CPP Investment Board (1998); and
- extension of benefits to same-sex common-law partners (2000).

The Canada Pension Plan continues to be an important part of Canadians' life-long financial well-being. With a strong fiscal framework in place, workers and their families can be confident that the Canada Pension Plan will be there for them when they need it.

2005-06 The Year at a Glance

- Changes to the Canada Pension Plan reflect the statutory increase in maximum pensionable earnings from $41,100 for 2005 to $42,100 for 2006. The contribution rate remained unchanged at 9.9 percent.
- 4.7 million Canadians received benefits from the Canada Pension Plan (CPP), with a total value of approximately $25 billion.
- About 3.2 million people received $17.7 billion in CPP retirement pensions.
- About 960,000 surviving spouses or common-law partners and 83,000 children of deceased contributors received over $3.7 billion in CPP benefits.
- About 296,000 persons with disabilities and 89,000 of their children received almost $3.4 billion in CPP disability benefits.
- Death benefits amounted to some $0.3 billion.
- Personal Statements of Contributions were received by 534,373 individuals between the age of 18 and 70.
- Administrative costs amounted to approximately $462 million, or 1.85 percent of the $25.0 billion in benefits paid. This compares favourably with administrative costs for other large pension plans and individual RRSPs.
- On March 31, 2006, total CPP net assets were valued at approximately $101.1 billion. The assets were held in provincial, territorial and federal government bonds, the Deposit with the Receiver General for Canada, the receivables net of liabilities, domestic and foreign publicly traded equities, money market securities, inflation-linked bonds, as well as private equity, real estate and infrastructure assets. Bonds, equities and real return assets are stated at fair value.

The Canada Pension Plan IN BRIEF

Almost everyone who participates in the paid labour force in Canada contributes to the Canada Pension Plan (CPP) or to its sister plan, the Quebec Pension Plan (QPP), and will at some time benefit from their provisions.

Established by an act of Parliament in 1965 and implemented in 1966, the CPP is a jointly managed federal-provincial plan. Quebec manages and administers its own plan, the QPP, and participates in the decision making of the CPP. Benefits from either plan are based on pension credits accumulated under both. The plans are financed through mandatory contributions from employees, employers and self-employed people, as well as from investment income. (QPP information is available from the Régie des rentes du Québec at www.rrq.gouv.qc.ca.)

While it is perhaps best known for its retirement pensions, the CPP also provides disability, death, survivor and children's benefits. The CPP administers the largest long-term disability plan in Canada. Besides paying monthly benefits to eligible disabled contributors and their children, vocational rehabilitation services and return-to-work supports assist some disability beneficiaries in returning to the workforce. In addition, an amendment to the CPP was passed in May 2004 to allow CPP disability recipients who return to work to have their benefits quickly reinstated if they cannot continue working should their disability recur.

Benefit calculations are based on how much and for how long a contributor has paid into the CPP and, in some cases, the age of the beneficiary. Benefits are not paid automatically—everyone must apply and provide proof of eligibility. Benefits are adjusted in January of each year as needed to reflect increases in the average cost of living, as measured by the Consumer Price Index (CPI).

Many Canadians live and work in other countries. Others move here after contributing to a public pension plan elsewhere. To help protect their pensions, Canada has entered into social security agreements with other nations. These agreements enable Canadians to receive public pensions from other countries and to receive CPP payments abroad. They also permit continuity of social security coverage when Canadians are temporarily working outside the country, eliminate duplicate contribution payments, and help them meet eligibility requirements for CPP and for other countries' public pensions.

Benefits AND EXPENDITURES

The number of people receiving CPP benefits has increased steadily over the past decade. To pay for these benefits, expenditures have also increased. Figure 1 shows the yearly increases in benefits and expenditures since 2002-03. Figure 2 (next page) shows the percentage of expenditures by type of benefit.

Retirement Pensions

Retirement pensions represent 70 percent of the total benefit dollars paid out by the CPP in 2005-06. The amount of each contributor's pension depends on how much and how long he or she has contributed and at what age he or she begins to draw the benefits. In March 2006, the monthly maximum retirement pension was $844.58; the average payment was $473.94.

The CPP offers flexibility with respect to the age of retirement. Contributors can take their pension as early as the age of 60 or receive a larger pension if they wait until after they turn 65 to begin receiving it. The CPP permanently reduces the pension by 0.5 percent per month for those who take their pension before reaching age 65, reflecting the fact that these seniors will, on average, receive their benefits longer than someone who retires at the age of 65.

Figure 1: **Benefits and Expenditures By Fiscal Year**

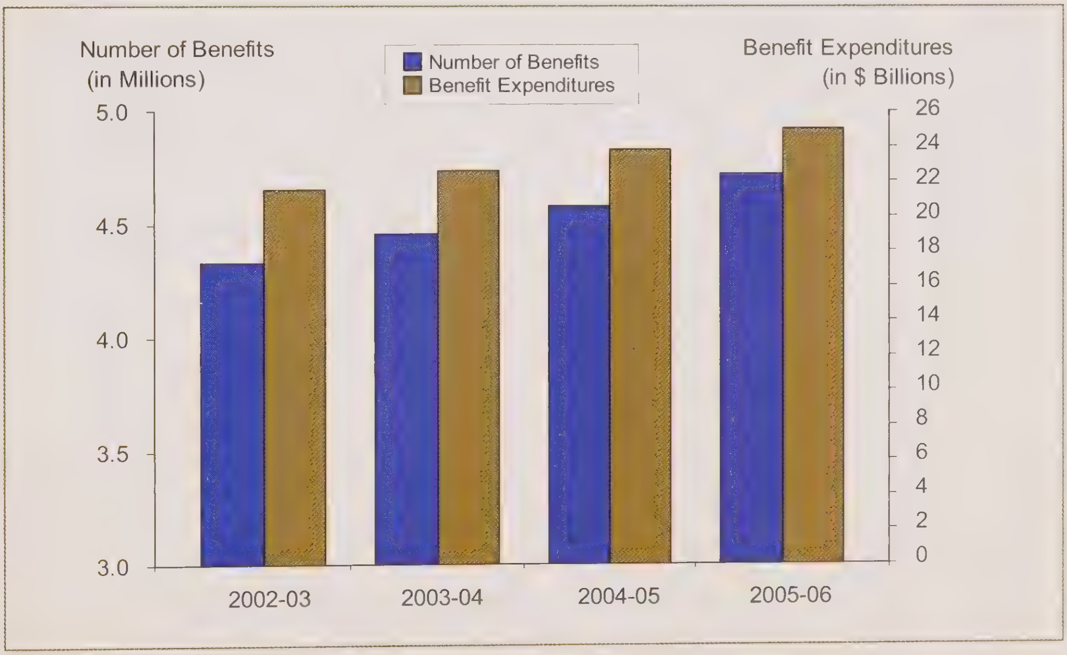
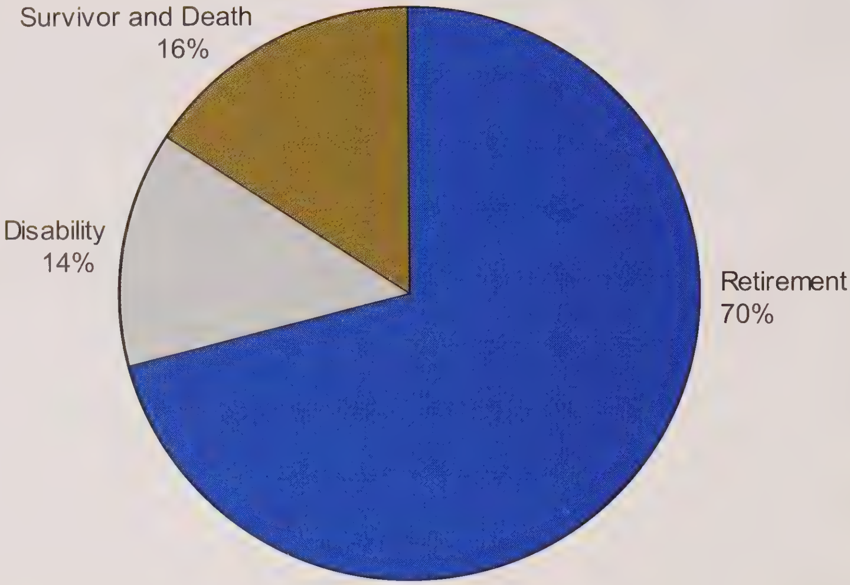


Figure 2: **Percentage of Benefit Dollars Paid For 2005-06**



For those who take their pension after reaching age 65, the CPP permanently increases the pension by 0.5 percent per month (up to a maximum of 30 percent), reflecting the fact that these seniors will receive their benefits for a shorter amount of time on average. The adjustments are intended to ensure that there is no advantage or disadvantage from taking the retirement benefit at a particular age. The Chief Actuary of the Canada Pension Plan completed a study on this issue in March 2003. The study is available at **www.osfi.gc.ca.**

Disability Benefits

Disability benefits, paid to eligible contributors and their children, represent 14 percent of the total benefit dollars paid out by the CPP in 2005-06. In March 2006, the maximum monthly disability benefit was $1,031.05; the average payment was $774.82. The children's monthly benefit was a flat rate of $200.47.

As part of Bill C-30, an amendment to the *Canada Pension Plan* was passed by Parliament in May 2004 to allow for automatic reinstatement

of CPP disability benefits. The required provincial consent was obtained, and the reinstatement amendment came into force January 31, 2005.

This change allows CPP disability clients who return to work to have their benefits quickly restarted if they cannot continue working because their disability recurs. This entitlement is available on application, for two years after CPP disability benefits are stopped because a client returns to regular employment. The provision covers CPP disability clients who report a return to regular employment and whose benefits are stopped on or after January 31, 2005.

Survivor Benefits

Survivor benefits, paid to the surviving spouse or common-law partner of the contributor and his/her dependent children, represent 15 percent of the total benefit dollars paid out by the CPP in 2005-06. The amount of the monthly survivor's pension varies depending on a number of factors, including the age of the spouse or common-law partner at death and whether the beneficiary also receives other CPP benefits. In March 2006, the maximum monthly survivor's pension at age 65 was $506.75; the average payment was $307.75. The children's monthly benefit was a flat rate of $200.47.

Death Benefits

Death benefits represent 1 percent of the total benefit dollars paid out by the CPP in 2005-06. The death benefit is a one-time payment. The maximum payable is $2,500; the average payment in March 2006 was $2,225.97.

Other Provisions

The CPP includes provisions that compensate for periods of low earnings, namely the Child Rearing Provision (CRP) and the 15 percent general drop-out provision. The CRP allows for periods during which a person has remained at home, or has reduced their participation in the workforce to care for children under the age of seven, to be excluded from the calculation of their benefits. All of the months following the birth of the child until the child reaches their 7th birthday can be removed, provided the contributor meets all criteria, including low or no earnings.

The general drop-out provision excludes 15 percent of a person's lowest earnings to help offset periods of low or nil earning such as those incurred during unemployment, illness or schooling. The Plan has other provisions under which married or common-law spouses may either share their retirement pensions (where the union is intact) or split their credits (where the union has ended).

The Appeals Process

There are three opportunities for review of a person's CPP benefit application. Most requests for review concern an application for disability benefits.

The first opportunity involves a request to the Minister of Human Resources and Social Development (see note on inside cover of this report) for a reconsideration (or administrative review) of a decision concerning a benefit, a division of pension credits or a pension sharing.

A person who is not satisfied with the decision made at the departmental reconsideration level can appeal to a Review Tribunal. A Review Tribunal is an independent body made up of three people chosen by the Commissioner of Review Tribunals from a panel of 100 to 400 part-time members appointed by the Governor-in-Council.

In 2005-06, the Office of the Commissioner of Review Tribunals (OCRT) received 4329 appeals under the Canada Pension Plan. In that same period, the OCRT issued 3091 decisions, of which 1772 (57 percent of the total) had been decided in favour of the appellant. In addition, another 324 cases were concluded as a result of settlements offered by the Department.

The next opportunity for appeal under the Canada Pension Plan is with the Pension Appeals Board, which is an administrative tribunal at arm's length from the government. Board members are judges or former judges of the superior courts of a province or the federal courts. At this level of appeal, the claimant or the Minister must first request "leave to appeal" or permission for a hearing. In 2005-06, 83 percent of applications reviewed were granted "leave" to proceed to a hearing. Hearings are held in major centres across Canada. Travel and accommodations are provided for parties who are requested to attend the hearing. Claimants may appear on their own behalf or with representation, while the Minister is represented by a lawyer. Most of the cases concern disability benefits. The hearings and the decisions are open to the public. This past year, 53 percent of the final decisions supported the claimants.

Decisions of the Pension Appeals Board may be brought to the Federal Courts for Judicial Review. The Federal Courts either uphold the decision or return it to the Pension Appeals Board for a new review.

Ensuring Financial Sustainability

As joint stewards of the CPP, the federal and provincial ministers of Finance review the Plan's financial state every three years and make recommendations as to whether benefits and/or contribution rates should be changed. They base their recommendations on a number of factors, including the results of an examination of the Plan by the Chief Actuary. The Chief Actuary is required under the legislation to produce an actuarial report on the CPP every three years (in the year before the legislated ministerial review of the Plan). The CPP legislation also requires the Chief Actuary to prepare an actuarial report any time a Bill is introduced in Parliament that, in the view of the Chief Actuary, has a material impact on the estimates in the most recent triennial actuarial report. This reporting ensures that the long-term financial implications of proposed Plan changes are given timely consideration.

Changes to the CPP legislation governing the general level of benefits, the rate of contributions or the investment policy framework can be made only through an act of Parliament. All such changes require the agreement of at least two thirds of the participating provinces, representing at least two thirds of the population. The changes come into force only after two years' notice, unless all the provinces waive this requirement, and after Provincial Orders-in-Council confirming the changes have been passed. Quebec participates in decision-making regarding changes to the CPP legislation, even though it administers its own plan. It is important that Quebec be involved in changes to the CPP to ensure the portability of QPP and CPP benefits across Canada.

Federal/Provincial/Territorial (FPT) Ministers of Finance completed the 2004-2006 triennial review of the CPP in June 2006. Ministers based their review on a number of factors, including the conclusions of the *Twenty-First Actuarial Report* on the Canada Pension Plan, prepared by the Chief Actuary of the Canada Pension Plan for the purpose of the review. They concluded that the Plan is on sound financial footing and can be sustained at the current contribution rate of 9.9 percent into the foreseeable future. Further information on this and previous reviews of the Plan can be found at **www.cpp-rpc.gc.ca.**

FPT Ministers further recommended two changes to the CPP: to allow long-term contributors to the CPP (that is, those with 25 years or more of contributions) to be eligible for the disability benefit if they have valid contributions in three, instead of four, of the last six years; and to establish guidelines for the operation of an existing financing provision in the CPP to fully fund any new benefits or benefit enhancements. Ministers agreed to make best efforts to implement these changes as soon as possible.

Actuarial Reporting

The *Twenty-First Actuarial Report* was tabled in Parliament by the Minister of Finance in December 2004. The report presented the financial status of the Plan as at December 31, 2003 and provides information to evaluate the Plan's financial sustainability over a long period, assuming Plan provisions remain unchanged. The findings of the report were an important element in the federal and provincial finance

ministers' triennial financial review of the CPP for 2004-2006. The previous triennial financial review of the Plan by ministers had been based on the findings of the *Eighteenth Actuarial Report* (as at December 31, 2000). Since that report, the Canada Pension Plan was subject to a series of amendments, whose financial implications were outlined in the *Nineteenth* and *Twentieth Actuarial Reports*.

Federal and provincial finance ministers have endorsed peer reviews of the triennial review. For this purpose, a panel of three independent Canadian actuaries, selected by the United Kingdom Government Actuary's Department (GAD) through an arm's length process, reviewed the *Twenty-First Actuarial Report*. The findings of the independent panel indicate that the report was competently prepared, the assumptions used in the Actuarial Report are reasonable and as a result, the conclusions of the Chief Actuary that the CPP is financially stable are well supported. It also stated that the Report meets current professional standards of actuarial practice and uses data and methodologies that are appropriate and reasonable. In addition to its conclusions, the panel made a number of recommendations regarding the preparation of future actuarial reports. The GAD concluded that the work done by the panel adequately addressed the issues. As a result, Canadians can have confidence in the results of the *Twenty-First Actuarial Report* and the conclusions reached by the Chief Actuary about the long-term financial health of the Plan.

The Office of the Chief Actuary (OCA) will study the panel's recommendations and give them due consideration in the preparation of future triennial actuarial reports. Since the first peer review, the OCA has developed a strong peer review process for its work. The panel's report and recommendations, as well as the actuarial reports and previous peer reviews can be found at **www.osfi.gc.ca.** The next statutory Actuarial Report as at December 31, 2006 is to be made public by the end of 2007. In preparation for that report, the OCA held a one-day seminar on the demographic and economic outlook for Canada to get opinions from a wide range of individuals with relevant expertise. The seminar was held in March 2006.

A Fair Approach to Funding

When it was introduced in 1966, the CPP was designed as a pay-as-you-go plan, with a small reserve. This meant that the benefits for one generation would be paid largely from the contributions of later generations. This approach made sense under the economic, financial and demographic circumstances of the time. The period was characterized by a rapid growth in wages and labour-force participation, and low rates of return on investments.

However, demographic and economic developments and changes to benefits in the 30 years that followed resulted in significantly higher costs. When federal and provincial finance ministers began their five-year statutory review of the CPP finances in 1996, contribution rates, already legislated to rise to 10.1 percent by 2016, were expected to have to rise again – to 14.2 percent by 2030 – to continue to finance the Plan on a pay-as-you-go basis.

Continuing to finance the Plan on a pay-as-you-go basis would have meant imposing a heavy financial burden on Canadians in the workforce 25 years down the road, which was deemed unacceptable by the federal and provincial governments. Therefore, in 1997, after extensive consultations with Canadians, they agreed instead to change the funding approach of the Plan to a hybrid of pay-as-you-go and full funding. Under full funding, each generation pays for its own benefits.

Steady-state Financing

To reduce the burden on future generations, the federal and provincial governments introduced "steady state" financing as part of the 1997 reform agreement. This approach requires that contribution rates be set no lower than the lowest rate expected to ensure the long-term financial stability of the Plan without recourse to further rate increases. At the time of the reforms, this was determined to be 9.9 percent. Therefore, under steady-state financing, the contribution rate was scheduled to increase incrementally (from 5.6 percent in 1996) to 9.9 percent in 2003, and to remain at this level thereafter.

According to the Chief Actuary of Canada, steady-state financing will generate a level of contributions that exceeds the benefits paid until 2022. Funds not immediately required to pay benefits will be transferred to the CPP Investment Board for investment.

Plan assets will accumulate rapidly over this period and over time will help pay the growing costs that are expected as more and more "baby boomers" begin to collect their retirement pension.

In 2022 and thereafter, when most of the baby boomers will have retired, and benefits paid begin to exceed contributions, investment revenues from the CPP accumulated assets will provide the funds necessary to make up the difference. However, contributions will remain the main source of funding for benefits.

The steady-state financing approach has moved the CPP away from pay-as-you-go financing (with a small reserve) towards fuller funding. By 2025, the Plan is expected to be about 25 percent pre-funded (i.e., Plan assets cover about 25 percent of obligations) compared to about 7 percent funded at the time of the 1997 agreement. The move to steady-state financing and the other changes agreed to in 1997 have reduced the relative size of the Plan's unfunded liability (obligations not covered by assets) in a manner that is fair across generations. Moving to full-funding, which would have eventually eliminated the unfunded liability, would have created unfairness across the generations. During the transition, contributors of some generations would have had to pay much higher contributions than others—they would have had to pay for the benefits of current retirees and for the development of a reserve to cover their own pensions. Continuing with a pay-as-you-go approach would also have been unfair, as it would have meant a sharp increase in the contribution rate over the coming decades.

According to the *Twenty-First Actuarial Report,* as at December 31, 2003, the Plan is 12 percent funded. This results in an unfunded liability of $516.3 billion. The relative size of the unfunded liability will decline over time as Plan assets grow more rapidly than Plan liabilities over the next few decades. Thereafter, Plan assets will grow at least as quickly as liabilities. The evolution of the funding level and the projected growth rates of assets and liabilities are better measures of the future financial health of the CPP than is the notion of the unfunded liability at a particular point in time.

A partially funded CPP not only balances the two approaches to funding, but also contributes to diversifying the funding of Canada's retirement income system, which includes:

- the Old Age Security program, funded by federal government revenues, and
- private savings, including tax-deferred, fully funded employer-sponsored pension plans and registered retirement savings plans (RRSPs).

A diversified funding approach allows Canada's retirement income system to be less vulnerable to changes in economic and demographic conditions than are systems in countries that use a single funding approach. In addition, the Canadian approach to pension provision, based on a mix of public and private pensions, is an effective way to provide for retirement income needs, according to international organizations.

Financial Accountability

Since 1999-2000, the CPP has used the accrual basis of accounting for revenues and expenditures. This method gives administrators a detailed financial picture and allows accurate matching of revenue and expenditures in the year in which they occur.

As at March 31, 2006, total CPP net assets were valued at approximately $101.1 billion. The Plan's net assets are composed of contributions and investment income that have accumulated since the Plan's inception in 1966, less benefit and administrative expenditures over the same period. According to the Chief Actuary, Plan net assets are expected to increase appreciably over the next 20 years.

CPP Account

A separate account, the CPP Account, has been established in the accounts of the Government of Canada to record the financial elements of the Plan: contributions, interest, pensions and other benefits paid, and administrative expenditures. The CPP Account also records the amounts transferred to or received from both the CPP Investment Fund and the CPP Investment Board. Spending authority is limited to the Plan's net assets. The CPP assets are not part of the federal government's revenues and expenditures.

Prior to the coming into force of Bill C-3 *(An Act to Amend the Canada Pension Plan and the Canada Pension Plan Investment Board Act)*, the Canada Pension Plan Investment Board was responsible for investing net new funds, while the CPP Account's operating balance and bond portfolio were managed by the Government of Canada. The amended legislation provides for the transfer of CPP assets that were previously administered by the federal government to the CPP Investment Board (CPPIB), beginning in 2004. These assets consist of the bonds held by the CPP Investment Fund and a portion of the deposit with the Receiver General for Canada. The CPPIB and the federal government have signed an agreement governing the transfer of the assets. The bonds are being transferred to the CPPIB over a three-year period that started in May 2004. Funds on Deposit with the Receiver General for Canada were fully transferred to the CPPIB over a period of twelve months that began in September 2004.

CPP Assets and Cash Management

The agreement between CPPIB and the federal government also stipulated that the CPP would transfer any excess cash, once the benefit and administration expenses had been paid, to the CPPIB in order to gain a better return. The CPP produces cash flow forecasts to determine the funds to be transferred to or from the CPPIB and these are updated regularly.

The CPP works closely with the CPPIB, various government departments and banks to coordinate these transfers and to put in place a tightly controlled process. A control framework is in place to ensure that the transfer process is followed properly and that all controls put in place are respected. For instance, the CPP obtains confirmations from all critical points during the transfers and can therefore follow the cash from one site to the next.

Since September 2004, the CPP has been transferring between $200 and $800 million to the CPPIB each week and receiving between $1.5 and $2 billion from CPPIB at the end of each month to cover the main benefit payments.

CPP Investment Board

The CPP Investment Board was created by an Act of Parliament in December 1997 to invest funds not required by the Canada Pension Plan to pay current benefits.

The Board is independent of the CPP. It operates at arm's length from government and is overseen by an independent board of directors. Its legislated mandate is to manage funds transferred from the CPP in the best interests of the contributors and beneficiaries of the Plan. The Board is to invest CPP assets with a view to achieving a maximum rate of return, without undue risk of loss. The CPPIB must also consider the factors that affect the Plan's funding and its ability to meet its financial obligations.

The CPPIB has a long-term investment horizon. In his most recent report, the Chief Actuary of Canada estimates that contribution revenues will exceed CPP benefit payments and expenses well into the future, and that the CPP will not need money from investment income until 2022.

Further information on the Board's mandate, governance structure and investment policy can be found at **www.cppib.ca.**

CPP Investments

As at March 31, 2006, CPP investments consisted of $27.8 billion of fixed income securities, $4.4 billion of private equity and $8.5 billion of inflation-linked bonds, real estate and infrastructure and $57.3 billion in publicly traded stocks.

The CPP fund earned $13.1 billion for a return of 15.5 percent for the fiscal year ending March 31, 2006.

Investing for our Future

The CPP Investment Board believes that publicly traded equities will outperform fixed income assets over the long term. Consequently, the CPP Investment Board will continue to invest in publicly traded equities or stocks so that CPP assets are allocated in a way that reflects the long-term funding requirements of the Plan.

To complement its $57.3 billion public equity portfolio, which is mostly passive, the CPP Investment Board has expanded into private equities primarily through externally managed funds that provide venture capital and expansion financing to private companies. These investments are made through limited partnerships or pooled funds managed by investment firms in Canada and around the world.

As at March 31, 2006, private equity fund commitments by the CPPIB were approximately $13.3 billion, of which $4.4 billion has been drawn. These commitments are managed by more than 50 different external fund managers.

Like other major pension funds, the CPP Investment Board is looking for opportunities to increase investments in real return assets, such as real estate and infrastructure, because their value over time will likely track and surpass the general rate of inflation.

In compliance with its statutory requirement to hold a public meeting in each participating province at least once every two years, the CPPIB held public meetings in every province in January 2001, June 2002, September and October 2004. The next meetings are scheduled for 2006.

MANAGING the CPP

Collecting and Recording Contributions

Contributions to the CPP are paid on earnings between a minimum and a maximum amount. The minimum (which remains constant) is \$3,500 and the maximum is adjusted annually to reflect the growth in the average Canadian industrial wage. The maximum amount of pensionable earnings as of January 1, 2006, was \$42,100 (up from \$41,100 in 2005). Contributions stop once a contributor reaches the age of 70 or begins to receive a CPP retirement pension or disability benefit.

The contribution rate in 2006 is 9.9 per cent, equally split between employees and employers. People who are self-employed pay the full 9.9 percent. Employers and employees make approximately 94 percent of contributions; the remaining 6 percent comes from the self-employed. In 2005-06, contributions amounted to \$30.1 billion.

All CPP contributions are remitted to the Canada Revenue Agency (CRA). CRA also assesses and verifies earnings and contributions, advises employers and employees of their rights and responsibilities, conducts audits, and reconciles reports and T4 slips. To verify that contribution requirements are being met, CRA applies a compliance and enforcement process that can vary from a computerized data match to an on-site audit. There are approximately 1.5 million existing employer accounts. During 2005-06, CRA conducted 53,228 audits, concentrating on files with irregularities.

Overpayment of Benefits

Consistent with its mandate to manage the CPP effectively, SDC has procedures in place to detect benefit overpayments. During 2005-06, overpayments totaling \$53 million were detected. Of this amount, \$45 million was recovered and remission was granted of debts totaling \$4 million.

2004 Budget Changes

In 2004, the rules governing contributions to the Canada Pension Plan were amended. They now allow a new employer who immediately succeeds another as a result of a change in business structure, to take into account the contributions the predecessor employer made for that same employee when determining amounts due. This change was extended to situations where self-employed individuals become employees of a corporation controlled by them or vice versa. The new rules apply for every year after 2003.

Before this change, when a business was restructured – notably as a result of a winding up and immediate reconstitution under a different legal structure (e.g., where a limited partnership is reconstituted as a corporation) or the acquisition of a major portion of the employer's property or of a distinct part of the employer's business (e.g., where a distinct division of a business is sold to another enterprise) – employees were treated as if they had new employers. Employers were required to begin withholding CPP contributions anew and they could not take into account the contributions withheld at source by the

previous employer – even if there had been no interruption of service by the employee.

Other amendments clarify the annual employers' contributions amount required under the Act and specify that only amounts remitted in excess may be refunded to the employer.

These changes ensure harmonization of contribution requirements between the Canada Pension Plan and the Quebec Pension Plan. Further information about these changes can be obtained by contacting the Canada Revenue Agency at 1 800 959-5525.

Administrative Costs

In 2005-06, it cost approximately $462 million to administer the CPP, with SDC accounting for the largest portion at $269 million and HRSDC $21 million. CRA required approximately $101 million and Public Works and Government Services Canada (PWGSC) some $16 million, for services to the CPP. The Office of the Superintendent of Financial Institutions (OSFI), where the Office of the Chief Actuary is housed, accounted for about $1 million. The CPPIB reported $54 million in operating expenses.

CPP administrative expenses in 2005-06 represent 1.85 percent of the $25.0 billion in benefits paid. This ratio compares very favourably with that of other pension plans. CPP administrative costs also compare favourably with those of RRSPs. Table 3 presents the CPP's administrative expenditures for the last three years.

Table 1: **CPP Administrative Costs 2003-04 to 2005-06**

	Expenditures (in $ millions)		
Department/Agency	2003-04	2004-05	2005-06
SDC (formerly included with HRDC)	-	263	269
HRSDC (formerly included with HRDC)	-	10	21
Former HRDC	309	-	-
CRA	85	96	101
CPPIB operating expenses	19	31	54
PWGSC	15	16	16
OSFI	1	1	1
Finance Canada	.4	.3	.3
Total	429.4	417.3	462.3

Improved Service Delivery – Service Canada

The goal of Service Canada (SC) is to provide better, one-stop service to more Canadians in more communities, delivered with the right service attitude. Over time, it will bring federal services and benefits together, making it easier for Canadians to get more of the help they need in one place, whether by phone, on the Internet or in person.

Service Canada will integrate services from a number of federal departments to form a single service-delivery network. Over the next three years, Service Canada will continue to enhance and introduce more services with the goal of continuous improvement in service delivery and client satisfaction.

Reaching out to Canadians

During 2005-06, Service Canada (SC) continued its efforts to help Canadians better understand public pensions and the retirement income system, and to encourage them to actively plan and prepare for their own retirement. Information on the CPP is available in print, on the Internet, in person at local offices, by phone, and at electronic kiosks in government offices and public buildings. Personalized contact with clients continued to receive high priority. In 2005-06, SC issued personal CPP Statements of Contributions to 534,373 individuals between the ages of 18 and 70. The statements were accompanied by information on the retirement income system in Canada.

Delivering Service

In 2005-06, SC continued to modernize CPP program delivery. With the multi-year Information Technology Renewal project, staff now have access to a consolidated view of complete CPP and OAS client and benefit information, benefit payment history and lifetime CPP contributions. In addition, fully automated adjudication (determination of eligibility calculations of entitlement) has been introduced for CPP retirement benefits. Capabilities for automated adjudication of additional benefits will continue over the next several years. At the same time, SC continues to focus on maintaining the existing CPP information technology systems.

Processing Benefits

CPP services are offered in person, by telephone, online and by mail. In 2005-06, a total of 608,886 CPP applications were processed. This included 223,969 retirement applications, 91 percent of which were paid within the first month of entitlement. During the same period, the department processed 67,602 disability applications. Decisions on 71 percent of all CPP disability applications, which are complex and require medical information, were made within 120 calendar days of receipt of the completed application. Improved communication with clients and their physicians helped staff make well-informed decisions and helped CPP disability applicants better understand the reasons for decisions.

Table 2: Application Processing Statistics

National measures	Objective	2005-06 National
CPP Retirement applications paid on time*	85%	91%
CPP Disability Initial decisions made within 120 calendar days	75%	71%
CPP Disability Reconsideration decisions made within 120 calendar days	70%	69%

* *"On time" refers to when benefits were paid out within one month of the application being received.*

Table 3: Telephone Service Statistics

National measures	Objective	2005-06 National
Clients served by a service agent within 180 seconds of placing a call*	95%	93%

* *The objective is to serve clients within 180 seconds for 95 percent of calls.*

Looking to the Future – Service Canada

Information Technology Renewal Delivery System (ITR-DS)

Our systems were designed decades ago for a mail and paper-based operation. Updating our information systems that help deliver benefits is part of Service Canada's (SC) planned service delivery improvements. By replacing aging legacy systems with new technology, SC will transform from a paper organization to an electronic one. Staff will work with one tool for both CPP and OAS. The new system will standardize and automate benefit adjudication and entitlements and support new modes of service delivery. The new system is being developed in stages and substantial new functionality is already available. For example, staff now has access to automated tools for the CPP Retirement pension, which ensures accurate benefit payments to clients.

The system will also support better decision making by improving the information available to clients and staff through faster and more up-to-date technology. These improvements will further reduce the paper burden and the complexity of the application process.

Online Service Delivery

SC has taken steps to implement a number of self-service web-based options. They will allow clients to access a wider range of inquiries and client transactions online. They will also provide more integrated information on related benefits.

View and Update Personal Information
As of June 2005, CPP clients can access their personal information securely online. Using this service, they can view and update their mailing address and direct deposit information, and view their monthly payment amount. In coming years, enhancements will continue, allowing clients to view and update more information.

Streamlined and Automated CPP Statement of Contributions
Since April 2003, CPP contributors have been able to submit an online request to have their Statement of Contributions mailed to them. As of May 2005, clients can also view and print their personalized CPP Statement of Contributions information.

Tax Information Slips Online
Since 2004, CPP clients have been able to view their CPP T4 slips online, starting with those for the 2003 taxation year. They can also choose to stop having paper tax slips mailed to them, and to view and print their T4 slips online instead.

To increase the use of online services, SC has promoted awareness of the services and has encouraged clients to try them. Activities include: targeted mailing of promotional inserts in existing mass mailings, the inclusion of promotional messages within standard client correspondence, and improved navigation to the online services on the Service Canada home page. Seasonal promotional activities are also undertaken where appropriate, such as promoting the online tax slip service during the tax filing season. A significant increase in use of online services is anticipated when the next generation of seniors begins to apply for pension benefits.

The next step in the transition to an electronic based organization is the implementation of the "My Service Canada Account". This online service will provide a single entry-point for several applications, including the CPP View and Update Personal Information, the online Statement of Contributions and the Tax information slips online.

Simplifying the Application Process

SC has reviewed its current retirement benefit application processes so that clients can apply for benefits through streamlined, client-driven and more efficient service.

The result was a simplified CPP Retirement application form with an integrated Child Rearing Provision section. Further, most applicants no longer need to prove their date of birth with documentary evidence since the department now validates age through an electronic exchange with the Social Insurance Registry.

Future plans include similar improvements for other CPP benefits such as the Death, Survivor and Disability benefits.

Reaching all Canadians

Service Canada programs help millions of people in Canada every day. The Department's primary objective is that every Canadian receives the benefits to which he or she is entitled under its programs in a timely way.

The Internet has a tremendous ability to reach Canadians. Service Canada leads the development of a cross departmental website called Canada Benefits (**www.canadabenefits.gc.ca**). The site's mandate is to provide central access to government-wide benefit programs and services for individuals.

The Canada Benefits site provides access to federal, provincial and territorial programs and services. These include, among others, public pensions, employment insurance benefits and housing grants. The award-winning website supports the "citizen-first" principle, where information is organized according to the needs of Canadians and not the structures of government. For example, an interactive tool called the "Benefits Finder" provides citizens with a listing of programs and services relevant to their circumstances.

Through the Canada Benefits site and other means of communication, SC has been able to reach more Canadians than ever. Based on the firm conviction that all Canadians deserve financial security, SC strives to make them aware of the benefits available and helps them obtain those to which they are entitled.

Through 2005-06, SC worked closely with the voluntary sector, 'first-point-of-contact' service providers, and others, not only to help Canadians get benefits to which they are entitled, but also to lower the barriers experienced by vulnerable populations such as seniors with a low income, the homeless, those who experience low literacy and people with disabilities. Other partnership work this year extended our reach even further into communities through organizations that serve Aboriginal people and new Canadians and through the National Homelessness Initiative.

Over the past several years, the department has made a concerted effort to tell Canadians what they can expect from their public pensions and how they should prepare for their retirement. Striving to communicate as directly as possible, the CPP will continue improving and personalizing its programs to reach its clients.

Human Resources and
Social Development Canada

Ressources humaines et
Développement social Canada

Canada Pension Plan

Consolidated Financial Statements
for the year ended March 31, 2006

Canada

Management's responsibility for financial statements

The consolidated financial statements of the Canada Pension Plan have been prepared in accordance with Canadian generally accepted accounting principles for the public sector, by the management of Service Canada with the concurrence of the management of Human Resources and Social Development Canada (the Department).

Management is responsible for the integrity and objectivity of the information in the financial statements, including the amounts which must, of necessity, be based on best estimates and judgement. The financial information presented throughout the Annual Report is consistent with the financial statements.

In support of its responsibilities, management has developed and maintains systems of internal control and supporting procedures. They are designed to provide reasonable assurance that assets are safeguarded, recorded and properly maintained and transactions are properly authorized and are in accordance with the *Canada Pension Plan Act* and *Financial Administration Act* and accompanying regulations. These controls include the establishment of an organizational structure that provides a well defined division of responsibilities and accountability, the selection and training of qualified staff, and the communication of policies and guidelines throughout the organization. Internal controls are reviewed and evaluated by both internal and external auditors in accordance with their respective audits. Management also reviews the recommendations of its internal and external auditors for improvements in internal controls.

The Auditor General of Canada, the external auditor of the Canada Pension Plan, has conducted an independent audit of the consolidated financial statements in accordance with Canadian generally accepted auditing standards and has reported to the Minister of Human Resources and Social Development .

Sylvie C. Lafontaine, CA
Chief Financial Officer
Service Canada

Sherry Harrison, CMA
Comptroller
Human Resources and
Social Development Canada

Maryantonett Flumian
Deputy Head
Service Canada

Janice Charette
Deputy Minister
Human Resources and
Social Development Canada

August 18, 2006

Auditor General of Canada
Vérificatrice générale du Canada

AUDITOR'S REPORT

To the Minister of Human Resources and Social Development

I have audited the consolidated statement of net assets of the Canada Pension Plan as at March 31, 2006 and the consolidated statement of changes in net assets for the year then ended. These financial statements are the responsibility of the management of Human Resources and Social Development. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audit in accordance with Canadian generally accepted auditing standards. Those standards require that I plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In my opinion, these consolidated financial statements present fairly, in all material respects, the net assets of the Canada Pension Plan as at March 31, 2006 and the changes in its net assets for the year then ended in accordance with Canadian generally accepted accounting principles.

Sheila Fraser

Sheila Fraser, FCA
Auditor General of Canada

Ottawa, Canada
August 18, 2006

Consolidated Statement of Net Assets
As at March 31

	2006	2005
	(in millions of dollars)	
Assets		
Cash - Deposit with Receiver General for Canada	**151**	2,771
Receivables (Note 7)	**3,439**	2,363
Investments (Schedule, Note 3)	**99,196**	78,885
Other Assets	**12**	7
	102,798	84,026
Liabilities		
Accounts payable	**41**	53
Pensions and benefits payable	**62**	52
Tax deductions due to Canada Revenue Agency	**96**	84
Investment liabilities (Schedule, Note 3)	**775**	279
Due to brokers (Note 3)	**703**	147
	1,677	615
Net assets	**101,121**	83,411

Contingencies (Note 13)

The accompanying notes and consolidated schedule are an integral part of these consolidated financial statements.

Approved by:

Sylvie C. Lafontaine, CA
Chief Financial Officer
Service Canada

Sherry Harrison, CMA
Comptroller
Human Resources and
Social Development Canada

Maryantonett Flumian
Deputy Head
Service Canada

Janice Charette
Deputy Minister
Human Resources and
Social Development Canada

Canada Pension Plan

Consolidated Statement of Changes in Net Assets
for the year ended March 31

	2006	2005
	(in millions of dollars)	
Net assets, beginning of year	**83,411**	72,511
Increase		
Contributions	**30,117**	28,941
Investment income (Note 9)		
Interest income	**2,185**	2,431
Realised gains	**6,448**	1,742
Unrealised gains	**3,239**	1,212
Dividend income	**1,031**	736
Other income	**165**	38
Investment management fees	**(36)**	(20)
	13,032	6,139
	43,149	35,080
Decrease		
Pensions and benefits		
Retirement	**17,698**	16,822
Survivors	**3,466**	3,333
Disability	**3,111**	2,926
Disabled contributor's child	**269**	258
Death	**264**	249
Orphan	**218**	216
Net overpayments	**(49)**	(41)
	24,977	23,763
Operating expenses (Note 10)	**462**	417
	25,439	24,180
Net increase in net assets	**17,710**	10,900
Net assets, end of year	**101,121**	83,411

The accompanying notes and consolidated schedule are an integral part of these consolidated financial statements.

Canada Pension Plan

Consolidated Schedule of Investments
for the year ended March 31

	2006	2005
	(in millions of dollars)	
Equities		
Canadian equities		
Public markets	**20,003**	21,044
Private markets	**628**	512
	20,631	21,556
Non-Canadian equities		
Public markets	**27,743**	12,646
Private markets	**3,822**	2,394
	31,565	15,040
Total equities (Cost 2006 – $43,994; 2005 – $32,141)	**52,196**	36,596
Real return assets		
Public markets real estate	**1,178**	384
Private markets real estate	**3,676**	638
Inflation-linked bonds	**3,837**	-
Private markets infrastructure	**350**	230
Total real return assets (Cost 2006 – $8,635; 2005 – $1,222)	**9,041**	1,252
Nominal fixed income		
Bonds (Note 3)	**26,452**	27,841
Money market securities	**10,356**	12,067
Total nominal fixed income (Cost 2006 – $34,634; 2005 – $36,954)	**36,808**	39,908
Total investments	**98,045**	77,756
Investment receivables		
Accrued interest	**764**	803
Derivatives receivables	**259**	240
Dividends receivables	**128**	86
Total investment receivables (Cost 2006 – $641; 2005 – $340)	**1,151**	1,129
Total investments and investments receivable	**99,196**	78,885
Investments liabilities		
Debt on real estate properties	**(664)**	(242)
Derivatives liabilities	**(111)**	(37)
Total investments liabilities (Cost 2006 – $666; 2005 – $234)	**(775)**	(279)
Total net investments	**98,421**	78,606

1. Description of the Canada Pension Plan

a) Description of the CPP

The Canada Pension Plan (CPP) is a federal/provincial plan established by an Act of Parliament in 1965.

The CPP began operations in 1966. It is a compulsory and contributory social insurance program operating in all parts of Canada, except Quebec, which operates the Régime des rentes du Québec, a comparable program. The Plan's objective is to provide a measure of protection to workers and their families against the loss of earnings due to retirement, disability or death.

The Minister of Human Resources and Social Development is responsible for the administration of the *Canada Pension Plan* (the CPP Act); the Minister of National Revenue is responsible for collecting contributions. The Minister of Finance and his provincial counterparts are responsible for setting CPP contribution rates, pension and benefit levels and funding policy. The CPP Investment Board is responsible for managing amounts that are transferred to it under Section 108.1 of the *Canada Pension Plan*, and its interest in any debt securities transferred to it, in the best interests of the beneficiaries and contributors under that Act.

In accordance with the CPP Act, the financial activities of the Canada Pension Plan are recorded in the CPP Account (Note 8). The Plan's investments are held by the CPP Investment Fund (Note 4) and the CPP Investment Board (CPPIB). The financial transactions affecting the Account and the Investment Fund are governed by the CPP Act and regulations. The Investment Board's transactions are governed by the *Canada Pension Plan Investment Board Act* and the accompanying regulations. The CPP Investment Board's assets are to be invested with a view to achieving a maximum rate of return without undue risk of loss, having regard to the factors that may affect the funding of the CPP and the ability of the CPP to meet its financial obligations on any given business day.

The CPP Investment Board and its subsidiaries are exempt from Part I under paragraphs 149(l)(d) and 149 (l)(d.2) of the *Income Tax Act (Canada)* on the basis that all of the shares of the CPP Investment Board and its subsidiaries are owned by Her Majesty the Queen in right of Canada or by a corporation whose shares are owned by Her Majesty the Queen in right of Canada, respectively.

The CPP Investment Board is designed to operate at arm's length from the government. It is required to be accountable to the public, Parliament (through the federal Minister of Finance), and the provinces. It provides regular reports of its activities and the results achieved.

As stated in the CPP and CPPIB Acts, changes to these Acts require the approval of at least two-thirds of the provinces having, in the aggregate, not less than two-thirds of the population of all included provinces.

b) Financing

The CPP is financed by contributions and investment returns. Employers and employees pay contributions equally to CPP. Self-employed workers pay the full amount.

The CPP was designed initially to be financed on a pay-as-you-go basis, which means that the Plan would operate on a current basis with pensions and benefits being paid out of current contributions. With changes made to the Act in 1997, CPP is now intended to be funded on a "steady-state" basis – that is, combined contributions of 9.9% of pensionable earnings are expected to provide a capitalization level of 25% of the Plan's liability by the year 2025.

The CPP Act provides that an actuarial report shall be prepared every three years for purposes of the review of the financial state of the CPP by the Minister of Finance and his provincial counterparts. The Twenty-first Actuarial Report of the Chief Actuary of the Office of the Superintendent of Financial Institutions was tabled on December 8, 2004. The report concluded that the CPP is financially sound and the 9.9% combined employee-employer contribution rate reached in 2003 is expected to be sufficient to sustain the Plan in the face of an aging population.

A number of assumptions such as long term rate of return on assets, inflation rate, mortality rates, increase in salary and benefit rates, among other things, were used in the twenty first actuarial report. These assumptions reflect best estimates of future economic and demographic events. The next actuarial report as at December 31, 2006 is expected to be completed by December 2007.

c) Net assets of the Plan

The net assets of the Plan are composed of the deposit with the Receiver General for Canada, bonds and other net assets held on behalf of the CPP by the Government of Canada (GoC) and investments held by the CPPIB. They represent funds accumulated for the payment of pensions, benefits and operating expenses. This amount does not cover the actuarial present value of accrued pensions and benefits.

As at March 31, 2006, the value of net assets of the Plan is $101.1 billion (2005 – $83.4 billion). This amount represents approximately 4.0 times the total of pensions and benefits in 2006 (2005 - 3.5 times). According to the twenty first Actuarial Report, this is expected to grow to 5.6 times by 2021.

d) Pensions and benefits

Retirement pensions – A retirement pension is payable to each contributor at age 60 or older, according to the provisions of the Act. The monthly amount is equal to 25% of the contributor's average monthly pensionable earnings during the pensionable period. The amount may be reduced or increased depending upon whether the contributor applies for a retirement pension before or after age 65. This adjustment cannot exceed 30%. The maximum new monthly pension payable at age 65 in 2006 is $844.58 (2005 – $828.75).

Disability benefits – A disability benefit is payable to a contributor who is disabled, according to the provisions of the Act. The amount of the disability benefit to be paid includes a flat-rate portion and an amount equal to 75% of the earned retirement pension. The maximum new monthly disability benefit in 2006 is $1,031.05 (2005 – $1,010.23).

Survivor's benefits – A survivor's benefit is payable to the spouse or common-law partner (the beneficiary) of a deceased contributor, according to the provisions of the Act. For a beneficiary under the age of 65, the benefit consists of a flat-rate portion and an amount equal to 37.5% of the deceased contributor's earned retirement pension. A beneficiary between the ages of 35 and 45 who is not disabled or who has no dependent children receives reduced benefits. For beneficiaries aged 65 and over, the benefit is equal to 60% of the retirement pension granted to the deceased contributor. The maximum new monthly benefit payable to a beneficiary in 2006 is $506.75 (2005 – $497.25).

Disabled contributor's child and orphan benefits – According to the provisions of the Act, each child of a contributor who is receiving disability benefits or a child of contributor who is deceased is entitled to a benefit as long as the child is under the age of 18, or is between the ages of 18 and 25 and attending school full-time. The flat-rate monthly benefit in 2006 is $200.47 (2005 – $195.96).

Death benefits – According to the provisions of the Act, a death benefit is a one-time payment to, or on behalf of, the estate of a contributor. The benefit amounts either to 10% of the maximum pensionable earnings in the year of death or six times the monthly retirement pension granted to the deceased contributor, whichever is less. The maximum death benefit in 2006 is $2,500 (2005 – $2,500).

Pensions and benefits indexation – As required by the Act, pensions and benefits are indexed annually based on the Consumer Price Index for Canada. The rate of indexation for 2006 is 2.3% (2005 – 1.7%).

2. Significant accounting policies

a) Basis of presentation

These consolidated financial statements are presented on a consolidated basis. They include the consolidated financial position and the consolidated changes in net assets of the CPP Investment Board and CPP. These financial statements are prepared in accordance with Canadian generally accepted accounting principles for the public sector and conform to the disclosure and accounting requirements of the CPP Act.

These consolidated financial statements do not provide information on the actuarial estimates required to meet future obligations of the CPP since the CPP Act does not require that the pensions and benefits be pre-funded.

The CPP, which is under joint control of the Government of Canada and participating provinces, is not considered to be part of the reporting entity of the Government of Canada. Accordingly, its financial activities are not consolidated with those of the Government.

b) Valuation of investments, investment receivables and investment liabilities

Investments, investment receivables and investment liabilities are recorded on a trade date basis and are stated at fair value. Fair value is the amount of the consideration that would be agreed upon in an arm's-length transaction between knowledgeable, willing parties who are under no compulsion to act.

Fair value is determined as follows:

(i) Quoted market prices for publicly traded equities and unit values for public equity funds are used to represent fair value for these investments. Unit values reflect the quoted market prices of the underlying securities. In the case where quoted market prices are not reliable, such as those for securities that are not sufficiently liquid to be used as a basis for fair value, fair value is determined using accepted industry valuation methods.

(ii) In the case of private equity and infrastructure investments, where quoted market prices are not available, fair value is determined based on carrying values and other relevant information reported by external managers of the investments. These carrying values are determined by the external managers using accepted industry valuation methods. These methods include considerations such as earnings multiples of comparable publicly traded companies, discounted cash flows and third party transactions, or other events which would suggest a significant change in the value of the investment. On a quarterly basis, when there is evidence of a significant change in fair value, the valuation is adjusted as appropriate. In the first year of ownership, cost is generally considered to be an appropriate estimate of fair value for private equity and infrastructure investments unless there is evidence of a significant change in value.

(iii) The fair value of private markets real estate investments is determined using accepted industry valuation methods, such as discounted cash flows and comparable purchase and sales transactions. Debt on real estate investments is valued using discounted cash flows based on current market yields for instruments with similar characteristics. On a quarterly basis, when there is evidence of a significant change in fair value, the valuation is adjusted as appropriate. In the first year of ownership, cost is generally considered to be an appropriate estimate of fair value for real estate investments unless there is evidence of a significant change in value.

(iv) Fair value for over-the-counter derivatives such as swaps and forward contracts is determined based on the quoted market prices for underlying assets. Fair value for exchange-traded futures is based on quoted market prices.

(v) Quoted market prices are used to represent the fair value for inflation-linked bonds.

(vi) Quoted market prices are used to represent the fair value for public markets real estate.

(vii) Fair value for non-marketable federal, provincial and territorial bonds is calculated using discounted cash flows based on current market yields of instruments with similar characteristics, adjusted for the non-marketability and rollover provisions of the bonds.

(viii) Money market securities are recorded at cost, which, together with accrued interest income, approximates fair value.

c) Contributions

Contributions include CPP contributions earned for the year. The Canada Revenue Agency (CRA or the Agency) collects contributions and measures them using the assessment of tax returns. In determining the amount of contributions earned for the year, the Agency considers cash received and contributions assessed, and makes an estimate for contributions related to tax returns not yet assessed. This estimate is subject to review and adjustments. Adjustments, if any, are recorded as contributions in the year they are known.

d) Investment income recognition

Investment income is recorded on the accrual basis and includes realized gains and losses from investments, unrealized gains and losses on investments held at the end of the year, dividend income (recognized on ex-dividend date), interest income and net operating income from private markets real estate investments.

Realized gains and losses on investments sold during the year represent the difference between sale proceeds and cost, less related costs of disposition. Unrealized gains and losses represent the difference between the fair value and cost of the investments at the end of the year. The current year unrealized gains and losses represent the year-over-year change in this difference.

e) Translation of foreign currencies

Transactions in foreign currencies are recorded at the rates of exchange prevailing on the transaction date. Investments denominated in foreign currencies and held at the year end are translated at exchange rates in effect at the year end date. The resulting realized and unrealized gains and losses are included in investment income.

f) Pensions and benefits

Pensions and benefits are recorded when payable.

g) Tax deductions due to Canada Revenue Agency

Tax deductions due to CRA consists primarily of voluntary and non resident taxes withheld from pensions and benefit payments to CPP beneficiaries.

h) Net overpayments

Net overpayments are composed of overpayments of pensions and benefits that were established during the year less remissions of debts granted.

i) Operating expenses

Operating expenses are recorded in the year to which they relate.

j) Use of estimates

The preparation of consolidated financial statements in accordance with Canadian generally accepted accounting principles for the public sector requires management to make estimates and assumptions that affect the reported values of assets and liabilities as at the date of the financial statements, and income and expenses during the reporting period. Significant estimates and judgments are required principally in determining the reported estimated contributions, allowance for doubtful accounts and fair values of investments since these determinations include estimates of expected future cash flows, rates of return and the impact of future events. Actual results could differ significantly from those estimates.

k) Cash flow statement

It is management's opinion that a cash flow statement for the CPP Account is not necessary since information concerning operating activities, and their effects on the balance of the account with the Receiver General for Canada, are readily apparent in the Consolidated Statement of Changes in Net Assets.

3. Investments, investment receivables and investment liabilities

The CPP Investment Board has established investment policies in accordance with the CPPIB regulations which set out the manner in which their assets shall be invested. In setting the policies, the CPP Investment Board takes into consideration certain assets which are held outside of the CPP Investment Board and which are in the process of being transferred to the CPP Investment Board as set out in the following paragraph.

The CPP Act and an administrative agreement between Her Majesty the Queen in right of Canada and the CPP Investment Board (the “Agreement”) together provide for the transfer of certain specified CPP assets, currently administered by the federal government, to the CPP Investment Board. These assets, totalling $9.4 billion at fair market value as at March 31, 2006, consist of a portfolio of non-marketable federal, provincial and territorial bonds to be transferred to the CPP Investment Board in 36 instalments over a period that began May 1, 2004 and ends on April 1, 2007 (see Note 3d). The assets also included a cash operating reserve which was transferred to the CPP Investment Board in 12 equal installments over a period that began in September 2004 and ended in August 2005.

a) Derivative contracts

A derivative is a financial contract, the value of which is derived from the value of underlying assets, indexes, interest rates or currency exchange rates.

The CPP Investment Board uses derivatives to replicate the returns of Canadian equities, Non-Canadian equities and Non-Canadian inflation-linked bonds, and to manage asset weights and currency exposure. The CPP Investment Board has swaps outstanding to exchange money market interest payments for equity and inflation-linked bond payments. The CPP Investment Board also uses exchange-traded futures contracts and foreign exchange forwards to either increase or reduce exposure to underlying equity market or currency movements.
All derivative contracts have a term to maturity of one year or less. Notional amounts of derivative contracts are used to compute the cash flows and for determining the fair value of the contracts. Notional amounts are not recorded as assets or liabilities on the Consolidated Statement of Net Assets.

The notional amounts and fair value of derivative contracts held as at March 31 are as follows:

	2006		2005	
	(in millions of dollars)			
	Notional Amount	**Fair Value**	Notional Amount	Fair Value
Equity swaps	**8,874**	**169**	5,918	206
Equity futures	**1,047**	**(2)**	6,061	(6)
Foreign exchange forwards	**6,184**	**(14)**	2,094	3
Inflation-linked bond swaps	**126**	**(5)**	-	-
Total	**16,231**	**148**	14,073	203

b) Private equity investments

Private equity investments are generally made through ownership in limited partnership arrangements with a typical term of 10 years. The private equity investments represent equity ownerships or investments with the risk and return characteristics of equity.

The CPP Investment Board advances capital to the limited partnerships, a portion of which, commonly referred to as management fees, is used by the general partners to select and provide ongoing management support to the underlying companies. Management fees generally vary between 1% and 2% of the total amount committed to the limited partnerships, and are included as part of the CPP Investment Board's cost of the investments. During the year ended March 31, 2006, management fees of $87 million (2005 – $70 million) were included in the capital advanced to the limited partnerships and recorded as part of the cost of the investment. As discussed more fully in Note 2b, the carrying values of these investments are reviewed quarterly and any resulting adjustments are reflected as unrealized gains or losses in investment income (see Note 9).

c) Real return assets

The CPP Investment Board obtains exposure to real estate through investments in publicly traded securities and privately held real estate. Private markets real estate investments are held by a wholly-owned subsidiary and are managed on behalf of the CPP Investment Board by external advisors and managers through co-ownership arrangements. As at March 31, 2006, the subsidiary's share of these investments includes assets of $3,676 million (March 31, 2005 – $638 million) and $664 million of liabilities related to mortgage debt (March 31, 2005 – $242 million), with a weighted average fixed interest rate of 6.94% and terms to maturity of one to 21 years.

Included in the private markets real estate are investments in joint ventures. The CPP Investment Board's proportionate share of the fair value of assets and liabilities in joint ventures at March 31, 2006 is $3,312 million (March 31, 2005 – $481 million) and $664 million (March 31, 2005 – $242 million), respectively. The proportionate share of the revenues and expenses in joint ventures for the year ended March 31, 2006 is included in investment income (see Note 9) and totals $273 million (March 31, 2005 – $63 million) and $183 million (March 31, 2005 – $44 million), respectively.

Infrastructure investments are generally made directly or through limited partnership arrangements. The investments represent ownerships in entities that invest in infrastructure assets. Management fees for limited partnership infrastructure investments are treated similarly to private equity management fees as discussed in Note 3b. During the year ended March 31, 2006, management fees included in the capital advanced to the limited partnerships were $5.4 million (March 31, 2005 – $1.8 million).

Inflation-linked bonds provide for an average effective yield of 4.8% and the terms to maturity are as follows:

	Terms to Maturity				
(in millions of dollars)	Within 1 year	1 to 5 years	6 to 10 years	Over 10 years	Total
Inflation-linked bonds	-	429	623	2,785	3,837

Bonds

The following table provides information on disposals, re-investments, unrealized gains (losses) of bonds:

Provincial, territorial and Canada bonds
(in millions of dollars)

	March, 31 2005 at cost	Disposals	Re-Investments	**March, 31 2006 at cost**	**March, 31 2006 at fair value**	March, 31 2005 at fair value
Newfoundland and Labrador	**633**	51	24	**606**	**662**	698
Prince Edward Island	**140**	8	10	**142**	**154**	155
Nova Scotia	**1,079**	92	92	**1,079**	**1,168**	1,196
New Brunswick	**834**	46	46	**834**	**906**	921
Quebec	**96**	6	7	**97**	**106**	108
Ontario	**10,233**	1,214	1,372	**10,391**	**11,287**	11,377
Manitoba	**883**	126	-	**757**	**821**	997
Saskatchewan	**978**	113	20	**885**	**964**	1,095
Alberta	**2,883**	283	141	**2,741**	**2,983**	3,253
British Columbia	**3,778**	185	75	**3,668**	**4,043**	4,234
Yukon Territory	**4**	-	-	**4**	**4**	4
	21,541	2,124	1,787	**21,204**	**23,098**	24,038
Canada	**3,335**	240	-	**3,095**	**3,354**	3,803
Provincial, territorial and Canada bonds	**24,876**	**2,364**	**1,787**	**24,299**	**26,452**	**27,841**
CPP Investment Fund's share	**17,275**	1,289	397	**8,355**	**9,164**	19,334
CPP Investment Board's share	***7,601**	1,075	1,390	**15,944**	**17,288**	8,507
	24,876	**2,364**	**1,787**	**24,299**	**26,452**	**27,841**

* CPP transferred to CPP Investment Board bonds with a cost of $8,028 million during the year ending March 31, 2006 ($7,697 million – 2005)

The transfer to the CPP Investment Board of the CPP portfolio of non-marketable federal, provincial and territorial bonds began on May 1, 2004. Bonds of $9.2 billion based on fair market value at the time of transfer were transferred during the year ended March 31, 2006.

The non-marketable bonds issued by the provinces and territories and purchased by the CPP prior to 1998 contained a rollover provision which will permit these issuers, at their option, to roll over the bonds for a further 20-year term at a rate based on capital markets borrowing rates existing at the time of rollover. The non-marketable bonds are also redeemable at the option of the issuers for redemption amounts calculated in accordance with Section 110 of the *Canada Pension Plan*.

During the year, all disposals of bonds were made, at maturity date, at face value. The bonds are redeemable in whole or in part before maturity. The provinces and territories are permitted to redeem their bonds held by the CPP Investment Fund prior to their maturity at a value equivalent to market value. No bonds were redeemed by the provinces and the territories prior to maturity during the year ended March 31, 2006 (2005 – none).

Effective June 2005, the Agreement was amended to permit the CPP Investment Board to purchase replacement bonds directly from a province or territory upon the maturity of the non-marketable bonds issued

by the provinces and territories prior to 1998, subject to the relevant province or territory having entered into an agreement with the CPP Investment Board. The maximum term of such securities is 30 years including rollover periods. The issuer may elect to have the CPP Investment Board purchase a replacement debt security or securities in a total principal amount not exceeding the principal amount of the maturing security for a term of not less than five years and not greater than 30 years. Such replacement bonds contain rollover provisions which will permit the issuer, at its option, to roll over the debt security for successive terms of not less than five years and subject in all cases to the maximum 30 years outside maturity date. The replacement bonds are also redeemable at the option of the provinces or territories prior to maturity. Agreements between the CPP Investment Board and the relevant provinces or territories were effective commencing July 1, 2005.

The following schedule presents the fair value of the bonds by maturity dates and the average annual rate of return on bonds currently held based on current effective yields for similar type bonds:

	2006		2005	
	(in millions of dollars)			
	Investments at fair value	**Effective yield**	Investments at fair value	Effective yield
Investments maturing				
Within 1 year	**2,837**	**4.71%**	2,332	5.26 %
1 – 5 years	**11,965**	**5.02%**	10,467	5.01 %
Over 5 years	**11,650**	**5.17%**	15,042	5.54 %
Total – Investments	**26,452**		27,841	
Average effective yield on investments		**5.05%**		5.32 %

d) Commissions

Commissions are paid to brokers on purchases and sales of publicly traded equities. Commissions on purchases are included as part of the cost of publicly traded equities. Commissions on sales are deducted from realized gains and added to losses as a cost of disposition. During the year ended March 31,2006, the CPP Investment Board paid total brokerage commissions of $28 million (2005 – $11 million).

e) Securities lending

The CPP Investment Board participates in a securities lending program to enhance portfolio returns. Credit risk associated with the securities lending program is mitigated by requiring the borrower to provide daily collateral in the form of readily marketable investments of greater market value than the securities loaned. As at March 31, 2006, the CPP Investment Board's investments include securities loaned with an estimated fair value of $1,847 million (March 31, 2005 – $1,423 million). The fair value of collateral received in respect of the securities loaned is $1,942 million (March 31, 2005 – $1,496 million).

4. Investments held by the CPP Investment Fund

The Canada Pension Plan Investment Fund was established in the accounts of Canada by the CPP Act to record the Plan's investments in bonds of the provinces, territories and Canada. The CPP Investment Fund's bond portfolio is administered by the federal Department of Finance.

In accordance with the amended legislation and the related administrative agreement, the bonds held by the CPP Investment Fund are transferred to the CPP Investment Board. As at March 31, 2006, 23/36th of the Investment Fund has been transferred for approximately $18 billion (2005 – 11/36th for approximately $8.8 billion). Once all the bonds are transferred to the CPP Investment Board in April 2007, the CPP Investment fund will cease to exist.

For further bond details see Note 3d.

5. Investment risks

Investments, investment receivables and investment liabilities may be exposed to one or more of the following risks:

CURRENCY RISK. The CPP is exposed to currency risk through holdings of investments, investment receivables and investment liabilities in various currencies. Fluctuations in the relative value of the Canadian dollar against foreign currencies can result in a positive or negative effect on the fair value of investments. The net underlying currency exposures, after allocating foreign currency derivatives, are as follows:

(in millions of dollars)	**2006**		2005	
Currency	**Net Exposure**	**% of Total**	Net Exposure	% of Total
Canadian Dollar	**65,326**	**66**	62,223	79
United States Dollar	**17,353**	**18**	7,804	10
Euro	**5,900**	**6**	3,464	4
Japanese Yen	**3,370**	**4**	1,256	2
British Pound Sterling	**3,269**	**3**	2,086	3
Swiss Franc	**1,090**	**1**	340	-
Australian Dollar	**895**	**1**	462	1
Other	**1,218**	**1**	971	1
	98,421	**100**	78,606	100

INTEREST RATE RISK. Interest rate risk refers to the effect on the fair value of investments and investment liabilities due to fluctuations in interest rates. The fair value of the bonds and debt on real estate investments is directly affected by changes in interest rates.

MARKET RISK. Market risk is the risk that the value of an investment will be adversely affected by changes in market prices, whether those changes are caused by factors specific to the individual investment or factors affecting all securities traded in the market. The CPP Investment Board manages market risk by investing across a wide spectrum of asset classes and investment strategies to earn a diversified risk premium at the total fund, based on asset mix and risk limits established in the investment policies.

CREDIT RISK. The CPP limits credit risk by dealing with counterparties that have a minimum credit rating of A or R-1 (short-term) as determined by a recognized credit rating agency, where available, or as determined through an internal credit rating process. Credit exposure is limited to maximum amounts as specified in the investment policies.

LIQUIDITY RISK. The CPP is exposed to liquidity risk through its responsibility to pay benefits on a timely basis.

6. Credit facilities

The CPP Investment Board maintains $1.5 billion (March 31, 2005 - $1.6 billion) of unsecured credit facilities to meet potential liquidity requirements. As at March 31, 2006, the total amount drawn on the credit facilities is $nil (March 31, 2005 – $nil).

7. Receivables

	2006	2005
	(in millions of dollars)	
Receivables		
Contributions	**3,085**	2,278
Régime des rentes du Québec	**49**	30
Beneficiaries		
Balance of pensions and benefits overpayments	**86**	82
Allowance for doubtful accounts	**(50)**	(46)
Due from brokers	**255**	19
Other	**14**	-
	3,439	2,363

The Department has procedures to detect overpayments. During the year, overpayments totalling $53 million (2005 – $46 million) were established and remissions of debts totalling $4 million (2005 – $5 million) were granted. A further $45 million was recovered (2005 – $41 million).

8. Canada Pension Plan Account

The CPP Account was established in the accounts of Canada by the CPP Act to record the contributions, interest, pensions, benefits and operating expenses of the Plan. It also records the amounts transferred to or received from the CPP Investment Fund and the CPP Investment Board.

In accordance with the amended legislation and the related agreement, funds on deposit with the Receiver General for Canada have been transferred to the CPP Investment Board on a monthly basis as explained in Note 3. As at March 31, 2006, all of the funds have been transferred (approximately $6.5 billion). As at March 31, 2006, the Deposit with the Receiver General for Canada is $151 million (2005 - $2,771 million).

9. Investment income

Investment income is reported net of external investment management fees. Investment management fees in respect of public markets investments are expensed as incurred. These fees include an incentive portion that fluctuates with investment performance. Investment management fees for private market real estate investments are deducted by the asset manager before the CPP Investment Board receives its share of net operating income from the properties. For a discussion of private equity and infrastructure management fees, see Notes 3b and 3c.

Investment income by asset class, net of external investment management fees and after giving effect to derivative contracts and investment receivables and liabilities, is as follows:

	2006	2005
	(in millions of dollars)	
Canadian equities [1,7]		
Public markets	**7,567**	3,827
Private markets [2]	**(25)**	70
	7,542	3,897
Non-Canadian equities		
Public markets	**3,054**	398
Private markets [2]	**597**	311
	3,651	709
Less : Public markets external investment management fees	**(30)**	(16)
	11,163	*4,590*
Real return assets		
Public markets real estate [3]	**298**	53
Private markets real estate [4]	**183**	48
Less : Private markets real estate external investment management fees	**(6)**	(4)
	177	44
Inflation-linked bonds	**57**	-
Private markets infrastructure	**(8)**	(2)
	524	*95*
Nominal Fixed Income[5]		
Bonds	**1,283**	1,315
Money market securities	**41**	10
	1,324	*1,325*
Interest on operating balance	***21***	*129*
Total investment income, net of external investment management fees [6]	**13,032**	6,139

1 Includes unrealized gains of $3,715 million (2005 – unrealized gains of $2,141 million), realized gains of $6,449 million net of external investment management fees (2005 – realized gains of $1,729 million net of external investment management fees), dividends of $993 million (2005 – $717 million) and securities lending income of $6 million (2005 – $3 million).

2 As described more fully in Note 2b, the carrying values of private equity investments are reviewed quarterly and any resulting adjustments are reflected as unrealized gains or losses in investment income.

3 Includes unrealized gains of $260 million (2005 – unrealized gains of $30 million), realized losses of $0.3 million (2005 – realized gains of $3.7 million) and dividends of $38 million (2005 – $19.6 million).

4 Includes private markets real estate operating income of $110 million (2005 – $37 million), which is net of debt interest of $42 million (2005 – $23 million), and unrealized gains of $73 million (2005 – unrealized gains of $11 million).

5 Includes interest income of $2,185 million (2005 – $2,431 million), realized losses of $31 million (2005 – realized losses of $7 million) and unrealized losses of $809 million (2005 – unrealized losses of $970 million).

6 Includes foreign exchange losses of $1,679 million (2005 – foreign exchange losses of $867 million).

7 In fiscal 2006, as a result of the removal of the foreign property restrictions under the *Income Tax Act (Canada)*, the CPP Investment Board elected to change its method of accounting for the cost of public markets equity investments from a total portfolio average cost basis to an individual portfolio-based approach. The change resulted in a reclassification of $443 million from realized gains to unrealized gains in fiscal 2006.

10. Operating expenses

	2006	2005
	(in millions of dollars)	
General operating expenses	**222**	205
Salaries and benefits	**232**	206
Professional and consulting fees	**8**	6
Total Operating expenses	**462**	417

11. Net Assets and Changes in Net Assets for accountability purposes

The administration of the Canada Pension Plan's assets and activities is split between various federal departments and the Canada Pension Plan Investment Board. The CPPIB is now responsible for managing the majority of the Plan's assets, while the Government of Canada, through various federal departments, manages the remainder of the assets, as well as the collection of the CPP contributions and the administration and payments of the CPP benefits. For accountability purposes, the following table presents summary information on the levels of assets and liabilities and sources of income and expenses managed by each the GoC and the CPPIB.

	2006			2005		
	GoC	CPPIB	**Total**	GoC	CPPIB	**Total**
			(in millions of dollars)			
Assets	12,750	90,048	**102,798**	24,998	59,028	**84,026**
Liabilities	161	1,516	**1,677**	167	448	**615**
Net assets	12,589	88,532	**101,121**	24,831	58,580	**83,411**
Income :						
Contributions	30,117	-	**30,117**	28,941	-	**28,941**
Investment income	839	12,193	**13,032**	1,125	5,014	**6,139**
	30,956	12,193	**43,149**	30,066	5,014	**35,080**
Expenses :						
Pensions and benefits	24,977	-	**24,977**	23,763	-	**23,763**
Operating expenses	408	54	**462**	386	31	**417**
	25,385	54	**25,439**	24,149	31	**24,180**
Increase in net assets	5,571	12,139	**17,710**	5,917	4,983	**10,900**

Pursuant to Section 108.1 of the *CPPIB Act* and the Agreement dated as of April 1, 2004, amounts not required to meet specified obligations of the CPP are transferred to the CPPIB. The funds originate from employer and employee contributions to the CPP, proceeds of maturing and redeemed government bonds held by the GoC on behalf of the CPP and interest income generated from this portfolio.

CPP transfers include an interest in the bond portfolio administered by the GoC for the CPP and a portion of the amount on deposit with the Receiver General. In September 2004, the CPPIB assumed responsibility for providing cash management services to the CPP, including periodic return, on at least a monthly basis of funds required to meet expenses and benefits. In accordance with the Agreement dated April 1, 2004, the 12 monthly payments to the CPPIB of a portion of the amount on deposit with the Receiver General were used to reduce the payments to the CPP for expenses and benefits as noted previously.

During the year ended March 31, 2006, the total of $34.5 billion transferred to the CPPIB includes bonds of $9.2 billion based on fair market value at the time of transfer and cash of $25.3 billion. During the same year a total of $16.7 billion (net of the amount on deposit with Receiver General transferred to CPPIB of $2.7 billion) was returned to the CPP to meet its liquidity requirements.

Transaction total for the year

	2006	2005
	(in millions of dollars)	
Canada Pension Plan Investment Board		
Accumulated transfers to CPPIB, beginning of year	**57,296**	29,824
Transfers of bonds titles and accrued interest	**9,201**	8,804
Transfers of funds to CPPIB	**25,298**	18,668
Accumulated transfers to CPPIB, end of year	**91,795**	57,296
Accumulated transfers from CPPIB, beginning of year	**(6,669)**	-
Transfers of funds from CPPIB	**(16,686)**	(6,669)
Accumulated transfers from CPPIB, end of year	**(23,355)**	(6,669)
Accumulated net transfers to CPPIB	**68,440**	50,627

12. Commitments

The CPP Investment Board has committed to enter into investment transactions, which will be funded over the next several years in accordance with the agreed terms and conditions. As at March 31, 2006, the remaining commitments total $8.3 billion (March 31, 2005 – $5.4 billion).

As at March 31, 2006, the CPPIB has made lease commitments of $26.0 million (March 31, 2005 – $20 million) over the next eight years.

13. Contingencies

a) Appeals relating to the payment of pensions and benefits
At March 31, 2006, there were 8,226 (8,331 in 2005) appeals relating to the payment of CPP pensions and benefits. These contingencies are estimated at an amount of $36 million ($33 million in 2005). Any award made in favour of beneficiaries will be accounted for as an expense of the period in which the amount becomes determinable.

b) Class action

A class action was filed against the CPP for discrimination against survivors whose same-sex common-law partners died on or after April 17, 1985 and before January 1, 1998. On November 26, 2004, the Court of Appeal for Ontario ruled that eligible class members, whose partners died between April 17, 1985 and January 1, 1998, will be entitled to receive pension payments. On January 25, 2005, both the government and counsel for the class members sought leave to appeal to the Supreme Court of Canada. Both requests for leave were granted on June 23, 2005. On May 16, 2006, the case was heard by the Supreme Court of Canada. The decision of the Supreme Court is expected later this year.

On July 12, 2005, the Ontario Superior Court endorsed the agreement of the Government of Canada and the counsel for the class members to pay interim Survivor's Pensions to class members who currently have an active and complete application with the department. Where the CPP eligibility criteria are met, the interim payment may have a maximum retroactive date of January 1st, 2003. In the event that the Supreme Court of Canada reverses the decisions of the lower courts, these interim payments would have to be reimbursed to the CPP. The ultimate contingency involved in this class action is estimated at an amount between $71 and $132 million.

c) Guarantees and indemnifications

The CPP Investment Board provides indemnifications to its officers, directors and, in certain circumstances, to various counterparties. The CPP Investment Board may be required to compensate these parties for costs incurred as a result of various contingencies such as changes in laws and regulations and litigation claims. The contingent nature of the indemnification agreements prevents the CPP Investment Board from making a reasonable estimate of the maximum potential payments the CPP Investment Board could be required to make. To date, the CPP Investment Board has not received any claims nor made any payments for such indemnifications.

14. Related party transactions

In addition to the information already disclosed in the other notes to the consolidated financial statements, the CPP has $3,085 million (2005 - $2,278 million) of contributions receivable from the Canada Revenue Agency and accounts receivable of $14 million (2005 – accounts payable of $32 million) from the Government of Canada for the administration of the Plan.

The CPP enters into transactions with the Government of Canada in the normal course of business at exchange value. The costs are based on estimated allocations of costs and are charged to the CPP in accordance with the memoranda of understanding.

Transaction total for the year

	2006	2005
	(in millions of dollars)	
Pension and benefit delivery, accommodation and corporate services		
Social Development Canada	**269**	263
Human Resources and Skills Development Canada	**21**	10
	290	273
Collection of contributions		
Canada Revenue Agency	**101**	96
Cheque issue and computer services		
Public Works and Government Services Canada	**16**	16
Actuarial services		
Office of the Superintendent of Financial Institutions	**1**	1
	408	386

15. Comparative figures

Certain comparative figures have been reclassified to conform to the current year's presentation.

Government of Canada Gouvernement du Canada

ANNUAL REPORT OF THE

CANADA PENSION PLAN 2006–07

Canada

Annual Report of the Canada Pension Plan 2006–07

Fiscal Year 2006–07

ISPB-203-12-07E

As of February 2006, the legal names of the minister and department responsible for the Canada Pension Plan (CPP) are the Minister of Human Resources and Skills Development and the Department of Human Resources and Skills Development respectively. Operationally, the department is styled as Human Resources and Social Development Canada.

The names of the departments previously responsible for the CPP, namely Human Resources Development Canada (HRDC) and/or Social Development Canada (SDC) are used in this report in a historical context only.

This report consolidates input from departments and agencies involved in the administration of the Plan: Human Resources and Social Development Canada (HRSDC), the Department of Finance, the Canada Revenue Agency (CRA), the Office of the Superintendent of Financial Institutions (OSFI) and the CPP Investment Board (CPPIB).

If you require additional copies of this report, it is available for printing at: **www.hrsdc.gc.ca**.

Cat. No. HS1-6/2007E
ISBN 978-0-662-47434-0

Or you may contact:

Publications/Distribution Unit
HRSDC Communications Branch
140 Promenade du Portage
Place du Portage, Phase IV, Level 0
Gatineau, Quebec K1A 0J9
Fax: 819-953-7260
E-mail: publications@hrsdc-rhdsc.gc.ca

Aussi disponible en français sous le titre *Rapport annuel du Régime de pensions du Canada 2006-2007*.

For more details on subjects covered in this report, or about the Canada Pension Plan in general, please visit: **www.hrsdc.gc.ca**.

If you have questions, please call (free of charge from Canada and the U.S.):

1-800-277-9914 (English)
1-800-277-9915 (French)
1-800-255-4786 (TTY)

Government of Canada Gouvernement du Canada

Her Excellency
The Governor General of Canada

May it please Your Excellency:

We have the pleasure of submitting the *Annual Report of the Canada Pension Plan* for the fiscal year 2006–07.

Respectfully,

James M. Flaherty
Minister of Finance

Monte Solberg
Minister of
Human Resources and Social Development

Canada

Table of Contents

2006–07: The Year at a Glance

- Changes to the Canada Pension Plan (CPP) reflect the statutory increase in maximum pensionable earnings from $42,100 for 2006 to $43,700 for 2007. The contribution rate remained unchanged at 9.9 percent.
- The *Twenty-First Actuarial Report* projects that 12.2 million Canadians will contribute to the CPP in 2007.
- 4.1 million Canadians received 4.9 million benefits from the CPP, with a total value of approximately $26.1 billion.
- About 3.3 million CPP retirement benefits were paid, totaling $18.7 billion.
- Benefits for approximately 979 000 surviving spouses or common-law partners and 82 000 children of deceased contributors were paid, totalling $3.8 billion.
- Benefits for approximately 304 000 people with disabilities and 90 000 of their children were paid, totalling $3.4 billion.
- About 117 000 death benefits were paid, totaling $0.3 billion.
- Personal Statements of Contributions are sent to Canadians on an ongoing basis. In 2006–07, 536 335 personal Statements of Contributions were sent to individuals between the ages of 18 and 70. An additional 19 149 were sent to individuals over 70 years of age.
- Administrative costs, including $114 million of the CPP Investment Board's operating expenses, amounted to approximately $574 million or 2.2 percent of the $26.1 billion in benefits paid. Although administrative costs increased, this compares favourably with administrative costs for other large pension plans and individual registered retirement saving plans (RRSPs).
- On March 31, 2007, total CPP net assets were valued at approximately $119.8 billion. The assets were held in: domestic and foreign public and private equities; provincial, territorial and federal government bonds; the Deposit with the Receiver General for Canada; the receivables net of liabilities; real estate; inflation-linked bonds; infrastructure; and money market securities. All assets are stated at fair value.

The Canada Pension Plan in Brief

lmost everyone who participates in the paid labour orce in Canada contributes to the Canada Pension lan (CPP) or to its sister plan, the Quebec Pension lan (QPP), and will at some time benefit from heir provisions.

stablished by an Act of Parliament in 1965 and nplemented in 1966, the CPP is a jointly managed ederal-provincial plan. Quebec manages and dministers its own plan, the QPP, and participates n decision making for the CPP. Benefits from either lan are based on pension credits accumulated under oth. The plans are financed through mandatory ontributions from employees, employers and elf-employed people, as well as from investment ncome. (QPP information is available from the Régie es rentes du Québec at www.rrq.gouv.qc.ca.)

Vhile it is perhaps best known for its retirement ensions, the CPP also provides disability, eath, survivor and children's benefits. The CPP dministers the largest long-term disability plan in anada. Besides paying monthly benefits to eligible ontributors with a disability and to their children, ne CPP also helps some disability beneficiaries eturn to the workforce through vocational ehabilitation services and return-to-work supports.

ill C-36 amended the *Canada Pension Plan* and eceived Royal Assent on May 3, 2007; provincial onsent is expected by January 2008. The largely dministrative amendments contained in this Bill nodernize and enhance services for seniors and nprove access for people with disabilities.

enefit calculations are based on how much and for ow long a contributor has paid into the CPP and in some cases, the age of the beneficiary. Benefits are not paid automatically—everyone must apply and provide proof of eligibility. Benefit amounts are adjusted in January of each year as needed to reflect increases in the average cost of living as measured by the Consumer Price Index (CPI).

Many Canadians live and work in other countries. Others move here after contributing to a public pension plan elsewhere. To help protect their pensions, Canada has entered into social security agreements with some 50 other nations. These agreements enable Canadians to receive public pensions from other countries and to receive CPP payments abroad. They also provide continuity of social security coverage when Canadians are temporarily working outside the country, eliminate duplicate contribution payments, and help people meet eligibility requirements for CPP and for other countries' public pensions.

Meeting the Needs of Canadians

For 41 years, the CPP has contributed to the income security of Canadians. It is a vital part of Canada's social safety net and retirement income system.

Over the years, changes have been made to better meet the needs of Canadians. These include:

- introduction of full annual cost-of-living indexation (1974);
- elimination of the difference in availability of survivor benefits to male and female contributors as well as to their surviving spouses and dependent children (1975);

- elimination of the retirement and employment-earnings test to receive a retirement pension at age 65 (1975);
- social security agreements with other countries that protect pensions for new Canadians and emigrants (1978);
- exclusion of zero- or low-earnings periods while caring for a child under the age of seven (1978);
- flexibility in receiving an actuarially adjusted retirement pension as early as age 60 or as late as age 70 (1987);
- credit splitting between spouses in the event of divorce (1978) or separation (1987);
- continuation of survivor's pensions if the surviving spouse remarries (1987);
- sharing of retirement pensions between spouses (1987);
- availability, as defined by the *Indian Act*, for individuals working on reserve to make CPP contributions (1988);
- major reforms to the CPP to restore the long-term financial health of the plan by moving to a new and unique financing approach that provides for the fuller funding of benefits as they accrue to the individual (1998);
- creation of the CPP Investment Board (1998); and
- extension of benefits to same-sex common-law partners (2000).

The reforms contained in Bill C-36 will help meet the Government of Canada's commitment to improve the accountability and transparency of government operations while improving fairness, equity and services for seniors.

The CPP continues to be an important part of Canadians' life-long financial well-being. With a strong fiscal framework in place, workers and their families can be confident that the CPP will be there for them when they need it.

Benefits and Expenditures

he number of people receiving Canada Pension lan (CPP) benefits has increased steadily over he past decade. To pay for these benefits, xpenditures have also increased. Figure 1 shows he yearly increases in benefits and expenditures ince 2003–04. Figure 2 (opposite page) shows the ercentage of expenditures by type of benefit.

Retirement Pensions

Retirement pensions represent 72 percent of the total benefit dollars paid out by the CPP in 2006–07. The amount of contributors' pensions depends on how much and for how long they have contributed and at what age they begin to draw the benefits. The maximum new monthly retirement pension in 2007 was $863.75. Based on March 2007 figures, the average payment was $482.18.

IGURE 1: CPP – Benefits and Expenditures By Fiscal Year

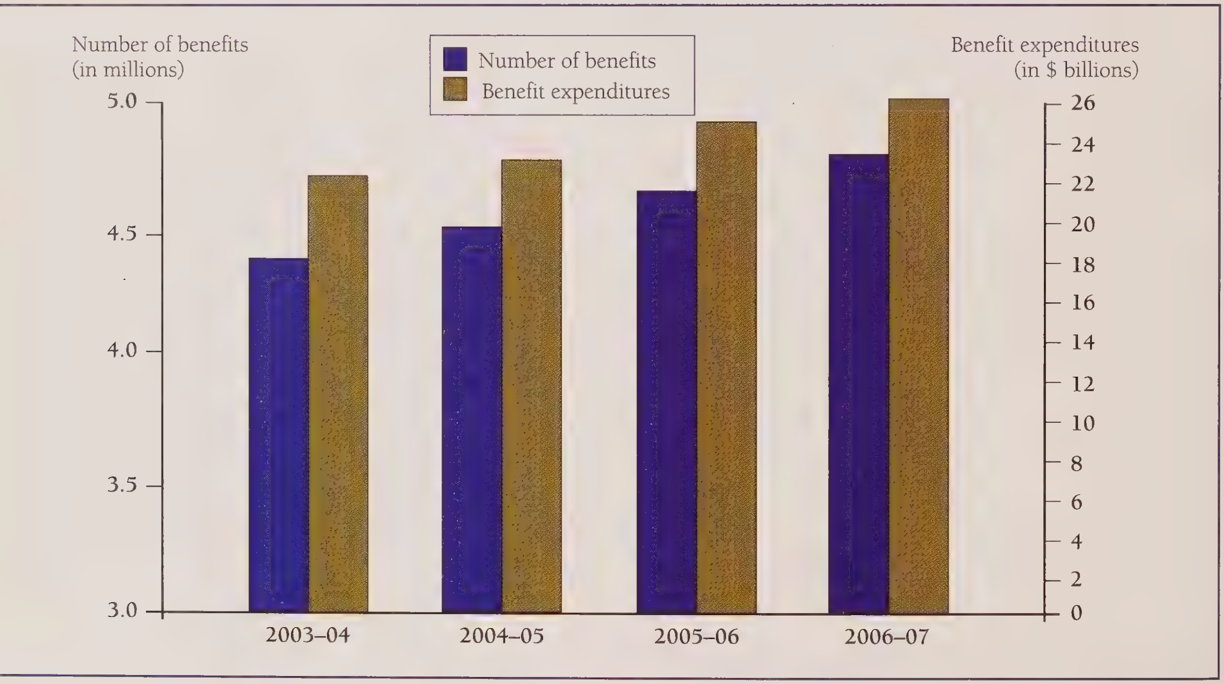
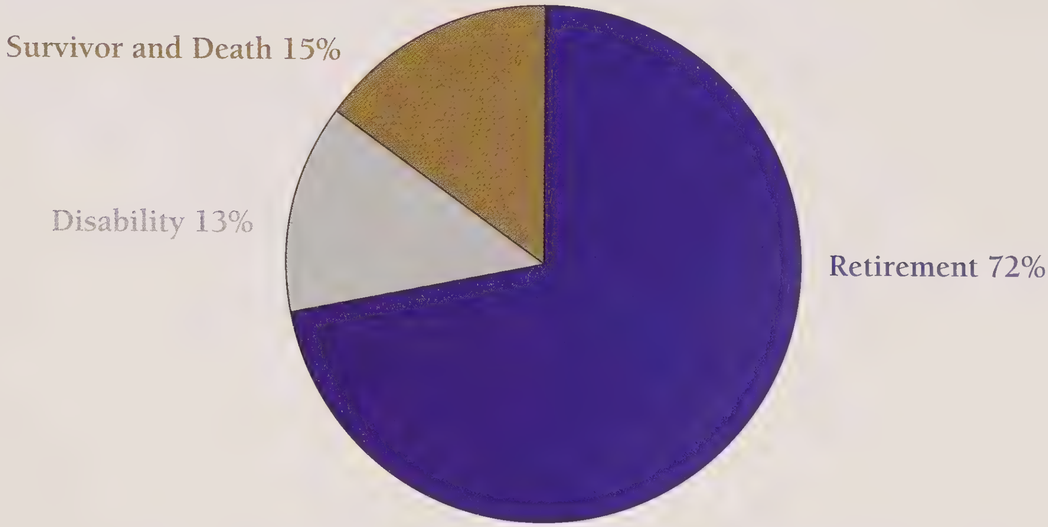


Figure 2: CPP – Percentage of Benefit Dollars Paid For 2006–07



The CPP offers flexibility with respect to the age of retirement. Contributors can take their flexible pension as early as age 60 or as late as age 70. The CPP permanently reduces the pension by 0.5 percent per month (up to a maximum of 30 percent) for those who take their pension before reaching age 65. This reflects the fact that these seniors will, on average, receive their benefits longer than someone who retires at the age of 65. For those who take their pension after reaching age 65, the CPP permanently increases the pension by 0.5 percent per month (up to a maximum of 30 percent). This reflects the fact that these seniors will receive their benefits for a shorter period of time, on average. The adjustments are intended to ensure that there is no advantage or disadvantage from taking the retirement benefit at a particular age. The Chief Actuary completed a study on this issue in March 2003. The study is available at **www.osfi.gc.ca**.

Disability Benefits

Disability benefits, paid to eligible contributors and their children, represent 13 percent of the total benefit dollars paid out by the CPP in 2006–07. The maximum new monthly disability benefit in 2007 was $1,053.77. Based on March 2007 figures, the average payment was $787.62. The children's monthly benefit was a flat rate of $204.68.

Survivor Benefits

urvivor benefits, paid to the surviving spouse or ommon-law partner of the contributor and his/her ependent children, represent 14 percent of the otal benefit dollars paid out by the CPP in 2006–07. he amount of the monthly survivor's pension aries depending on a number of factors, including ne age of the spouse or common-law partner at eath and whether the beneficiary also receives ther CPP benefits. The maximum new monthly urvivor's benefit in 2007 at age 65 was $518.25. ased on March 2007 figures, the average payment vas $313.37. The children's monthly benefit was a at rate of $204.68.

Death Benefits

Death benefits represent 1 percent of the total enefit dollars paid out by the CPP in 2006–07. The eath benefit is a one-time payment. The maximum ayable in 2007 was $2,500. Based on March 2007 gures, the average payment was $2,240.32.

Other Provisions

he CPP includes provisions that compensate or periods of low earnings, namely the Child earing Provision (CRP) and the 15 percent eneral drop-out provision. The CRP excludes rom the calculation of benefits the periods when ontributors have remained at home, or have educed their participation in the workforce to care or children under the age of seven. All months ollowing the birth of the child until the child reaches seven years of age can be removed, provided the contributor meets all criteria, including low or no earnings.

The general drop-out provision excludes 15 percent of a person's lowest earnings to help offset periods of low or nil earnings, such as those incurred during unemployment, illness or schooling.

The Plan has other provisions under which married or common-law spouses may either share their retirement pensions (where the union is intact) or split their credits (where the union has ended).

The Appeals Process

There are three opportunities for review of a person's CPP benefit application. Most requests for review concern disability benefit applications.

1. The first opportunity involves a request to the Minister of Human Resources and Social Development (see note on inside cover of this report) for a reconsideration or administrative review of a decision concerning a benefit, a division of pension credits or pension sharing.

2. A person who is not satisfied with the decision made at the departmental reconsideration level can appeal to a Review Tribunal, the first level of a two-tier formal appeal process. A Review Tribunal is an independent body made up of three people chosen by the Commissioner of Review Tribunals from a panel of 100 to 400 part-time members appointed by the Governor-in-Council.

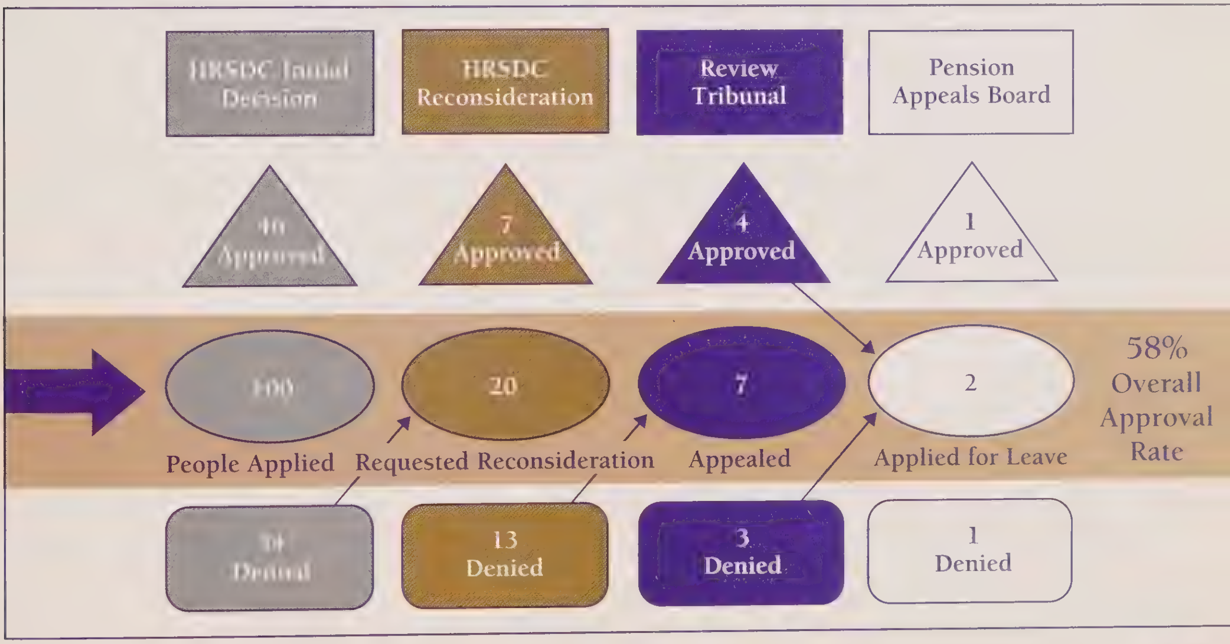
In 2006–07, the Office of the Commissioner of Review Tribunals (OCRT) received 4800 appeals under the CPP and held 3641 hearings. For appeals heard in that same period, the OCRT issued 2903 decisions, of which 1653 decisions (57 percent of the total) were decided in favour of the appellant. In addition, another 390 cases were concluded as a result of settlements offered by the Department.

3. The next opportunity for appeal under the CPP is with the Pension Appeals Board (PAB)—an administrative tribunal at arm's length from the government. Board members are judges or former judges of the superior courts of a province or the federal courts. At this level of appeal, the claimant or the Minister must first request "leave to appeal" or permission for a hearing.

In 2006–07, 82 percent of applications reviewed were granted "leave" to proceed to a hearing. Hearings are held in major centres across Canada. Travel and accommodations are provided for parties who are requested to attend a hearing. Claimants may appear on their own behalf or with representation, while the Minister is represented by a lawyer. Most of the cases concern disability benefits. The hearings and the decisions are open to the public. This past year, 49 percent of final decisions supported the claimants.

Decisions of the PAB may be brought to the Federal Court or Federal Court of Appeal for Judicial Review. The Federal Court either upholds a decision or returns it to the PAB for a new review.

Process of CPP Disability Applications 2006–07



Ensuring Financial Sustainability

s joint stewards of the Canada Pension Plan (CPP), ederal and provincial Finance ministers review the lan's financial state every three years and make ecommendations as to whether benefits and/or ontribution rates should be changed. They base heir recommendations on a number of factors, ncluding the results of an examination of the Plan y the Chief Actuary. The Chief Actuary is required nder the legislation to produce an actuarial report n the CPP every three years (in the first year of the egislated ministerial triennial review of the Plan). he CPP legislation also requires the Chief Actuary o prepare an actuarial report any time a Bill is ntroduced in Parliament that has a material impact, n the view of the Chief Actuary, on the estimates n the most recent triennial actuarial report. This eporting ensures that the long-term financial mplications of proposed Plan changes are given mely consideration.

Changes to the CPP legislation governing the eneral level of benefits, the rate of contributions r the investment policy framework can be made nly through an Act of Parliament. All such changes equire the agreement of at least two-thirds of the ncluded provinces, representing at least two-thirds f the population. The changes come into force nly after two years' notice, unless all the provinces vaive this requirement, and after Provincial Orders-in-Council confirming the changes have een passed. Quebec participates in decision naking regarding changes to the CPP legislation, ven though it administers its own plan. It is mportant that Quebec be involved in changes to he CPP to ensure the portability of QPP and CPP enefits across Canada.

Federal, provincial and territorial Finance ministers completed the 2004–06 triennial review of the CPP in June 2006. Ministers based their review on a number of factors, including the conclusions of the *Twenty-First Actuarial Report* on the CPP, prepared by the Chief Actuary for the purpose of the review. They concluded that the Plan is on sound financial footing and can be sustained at the current contribution rate of 9.9 percent into the foreseeable future. Details on this and previous reviews of the Plan can be found at **www.cpp-rpc.gc.ca**.

Federal, provincial and territorial Finance ministers recommended two changes to the CPP: the first was to allow long-term CPP contributors (that is, those with 25 years or more of contributions) to be eligible for the disability benefit if they have valid contributions in three, instead of four, of the last six years; the second change was to establish guidelines for the operation of an existing financing provision in the CPP to fully fund new benefits or benefit enhancements. Ministers agreed to make best efforts to implement these changes as soon as possible. These proposed changes were included in Bill C-36, which was tabled in the House of Commons in November 2006 and received Royal Assent in May 2007. The financial implications of Bill C-36 are outlined in the *Twenty-Second Actuarial Report*, which was tabled in the House of Commons in December 2006 and supplements the *Twenty-First Actuarial Report*. Bill C-36 will come into force once formal approval by at least two-thirds of the provinces, representing two-thirds of the population, is completed. This process is expected to be completed by the end of 2007.

Actuarial Reporting

The *Twenty-First Actuarial Report* was tabled in Parliament by the Minister of Finance in December 2004. The report presented the financial status of the Plan as at December 31, 2003, and provides information to evaluate the Plan's financial sustainability over a long period, assuming Plan provisions remain unchanged. The findings of the report were an important element in the federal and provincial Finance ministers' triennial review of the CPP for 2004–06.

Federal and provincial Finance ministers have endorsed peer reviews. For this purpose, a panel of three independent Canadian actuaries, selected by the United Kingdom Government Actuary's Department (GAD) through an arm's length process, reviewed the *Twenty-First Actuarial Report*. The findings of the independent panel indicate that the Actuarial Report was competently prepared, that the assumptions used in the report are reasonable and that the Chief Actuary's conclusion that the CPP is financially stable is well supported. It also stated that the report meets current professional standards of actuarial practice and uses data and methodologies that are appropriate and reasonable. In addition to its conclusions, the panel made a number of recommendations regarding the preparation of future actuarial reports. The GAD concluded that the work done by the panel adequately addressed the issues. As a result, Canadians can have confidence in the results of the *Twenty-First Actuarial Report* and the conclusions reached by the Chief Actuary about the long-term financial health of the Plan.

The Office of the Chief Actuary (OCA) will study the panel's recommendations and give them due consideration in the preparation of future triennial actuarial reports. Since the first peer review, the OCA has developed a strong peer review process for its work. The panel's report and recommendations, as well as the actuarial reports and previous peer reviews, can be found at **www.osfi.gc.ca**. The *Twenty-Third Actuarial Report* as at December 31, 2006, is to be made public by the end of 2007.

A Fair Approach to Funding

When it was introduced in 1966, the CPP was designed as a pay-as-you-go plan, with a small reserve. This meant that the benefits for one generation would be paid largely from the contributions of later generations. This approach made sense under the economic, financial and demographic circumstances of the time. The period was characterized by a rapid growth in wages and labour-force participation, and low rates of return on investments.

However, demographic and economic developments as well as changes to benefits in the following 30 years resulted in significantly higher costs. When federal and provincial Finance ministers began their five-year statutory review of the CPP finances in 1996, contribution rates, already legislated to rise to 10.1 percent by 2016, were expected to have to rise again—to 14.2 percent by 2030—to continue to finance the Plan on a pay-as-you-go basis. Continuing to finance the Plan on a pay-as-you-go basis would have meant imposing a heavy financial burden on Canadians in the workforce 25 years

own the road, which was deemed unacceptable y the federal and provincial governments.

herefore, amendments were put into effect in 998 to gradually raise the level of CPP funding by ncreasing contribution rates over the short term, educing the growth of benefits over the long term, nd investing cash flows in the private markets hrough the CPP Investment Board (CPPIB) to chieve higher rates of return. A further amendment vas included to ensure that stakeholders consider he full funding of any new or increased benefits rovided under the Plan.

he reform package agreed to by the federal nd provincial governments in 1997 included ignificant changes to the Plan's financing and unding provisions. The package included:

- the introduction of steady-state funding to replace pay-as-you-go financing, in order to build a reserve of assets (equivalent over time to about five years of benefit expenditures or about 25 percent of Plan liabilities). Investment earnings on this pool of assets would help to pay benefits when the large cohort of baby boomers retires.
- the introduction of incremental full funding, where changes to the CPP that increase or add new benefits would be fully funded. In other words, their costs would be paid as the benefit was earned and any costs associated with benefits that were paid but not earned would be amortized and paid for over a defined period of time, consistent with common actuarial practice.

Both of these funding objectives were introduced to improve fairness and equity across generations. The move to steady-state funding eases some of the contribution burden on future generations. Under full funding, each generation that receives benefit enrichments is more likely to pay for them in full and not pass on the cost to future generations.

At the time of the reforms, the minimum contribution rate that met these new financing objectives and ensured the long-term financial stability of the Plan was determined to be 9.9 percent. Therefore, the contribution rate was scheduled to increase incrementally (from 5.6 percent in 1996) to 9.9 percent in 2003, and to remain at this level thereafter.

Financing

According to the Chief Actuary, the new financing will generate a level of contributions that exceeds the level of benefits paid until 2022. Funds not immediately required to pay benefits will be transferred to the CPPIB for investment. The investment income from Plan assets will accumulate rapidly over this period and over time will help pay the growing costs that are expected as more and more baby boomers begin to collect their retirement pensions. In 2022 and thereafter, when most baby boomers will have retired, and benefits paid begin to exceed contributions, investment revenues from the CPP accumulated assets will provide the funds necessary to make up the difference. However, contributions will remain the main source of funding for benefits.

The new financing has moved the CPP away from pay-as-you-go financing (with a small reserve) towards fuller funding. By 2025, the Plan is expected to be about 25 percent pre-funded (i.e., Plan assets cover about 25 percent of obligations), compared with about 7 percent funded at the time of the 1997 agreement. This new financing and other changes agreed to in 1997 have reduced the relative size of the Plan's unfunded liability (obligations not covered by assets) in a manner that is fair across generations. Moving to full funding, which would have eventually eliminated the unfunded liability, would have created unfairness across the generations. During the transition, contributors of some generations would have had to pay much higher contributions than others; they would have had to pay for the benefits of current retirees and for the development of a reserve to cover their own pensions. Continuing with a pay-as-you-go approach would also have been unfair, as it would have meant a sharp increase in the contribution rate over the coming decades.

According to the *Twenty-First Actuarial Report*, as at December 31, 2003, the Plan is 12 percent funded. This results in an unfunded liability of $516.3 billion. The relative size of the unfunded liability will decline over time as Plan assets grow more rapidly than Plan liabilities over the next few decades. Thereafter, Plan assets will grow at least as quickly as liabilities. The evolution of the funding level and the projected growth rates of assets and liabilities are better measures of the future financial health of the CPP than is the notion of the unfunded liability at a particular point in time. A partially funded CPP not only balances the two approaches to funding, it also contributes to diversifying the funding of Canada's retirement income system, which also includes:

- the Old Age Security (OAS) program, funded by federal government revenues; and
- private savings, including tax-deferred, fully funded, employer-sponsored pension plans and registered retirement savings plans (RRSPs).

A diversified funding approach allows Canada's retirement income system to be less vulnerable to changes in economic and demographic conditions than are systems in countries that use a single funding approach. In addition, the Canadian approach to pension provision, based on a mix of public and private pensions, is an effective way to provide for retirement income needs.

Financial Accountability

ince 1999–2000, the Canada Pension Plan CPP) has used the accrual basis of accounting or revenues and expenditures. This method ives administrators a detailed financial picture nd allows accurate matching of revenue and xpenditures in the year in which they occur.

s at March 31, 2007, total CPP net assets were alued at approximately $119.8 billion. The lan's net assets are composed of contributions nd investment income that have accumulated ince the Plan's inception in 1966, less benefit nd administrative expenditures over the same eriod. According to the Chief Actuary, Plan net ssets are expected to increase appreciably over he next 20 years.

CPP Account

separate account, the CPP Account, has been stablished in the accounts of the Government of anada to record the financial elements of the Plan: ontributions, interest, pensions and other benefits aid, as well as administrative expenditures. The PP Account also records the amounts transferred o or received from both the CPP Investment Fund nd the CPP Investment Board (CPPIB). Spending uthority is limited to the Plan's net assets. The PP assets are not part of the federal government's evenues and expenditures.

rior to the coming into force of Bill C-3 (*An Act o Amend the Canada Pension Plan and the Canada ension Plan Investment Board Act*), the CPPIB was esponsible for investing net new funds, while the PP Account's operating balance and bond portfolio vere managed by the Government of Canada. The amended legislation provides for the transfer of certain specified CPP assets, currently administered by the federal government, to the CPPIB. These assets consist of the remaining portfolio of non-marketable federal, provincial and territorial bonds that have been transferred to the CPPIB at a rate of 1/36th every month since May 1, 2004. The last 1/36th, totaling $630 million at fair market value as at March 31, 2007, was transferred to the CPPIB on April 1, 2007.

CPP Assets and Cash Management

The agreement between CPPIB and the federal government also stipulated that the CPP would transfer any excess cash to the CPPIB, once the benefit and administration expenses had been paid, in order to gain a better return. The CPP produces cash flow forecasts to determine the funds to be transferred to or from the CPPIB and these are updated regularly.

The CPP continues to work closely with the CPPIB, various government departments and banks to coordinate these transfers and to manage a tightly controlled process. A control framework is in place to ensure that the transfer process is followed correctly and that all controls put in place are respected. For instance, the CPP obtains confirmations from all critical points during the transfers and can therefore follow the cash from one site to the next.

Since September 2004, the CPP has been transferring between $200 million and $1.2 billion to the CPPIB

each week and receiving approximately $1.5 to $2 billion from CPPIB at the end of each month to cover the main benefit payments.

CPP Investment Board

The CPP Investment Board was created by an Act of Parliament in December 1997 to invest funds not required by the CPP to pay current benefits.

The CPPIB is independent of the CPP. It operates at arm's length from government and is overseen by an independent board of directors. Its legislated mandate is to manage funds transferred from the CPP in the best interests of the contributors and beneficiaries of the Plan. The Board invests CPP assets to achieve a maximum rate of return, without undue risk of loss. The CPPIB must also consider the factors that affect the Plan's funding and its ability to meet its financial obligations.

The CPPIB has a long-term investment horizon. In his most recent report, the Chief Actuary estimates that contribution revenues will exceed CPP benefit payments and expenses well into the future, and that the CPP will not need money from investment income until 2022.

Further information on the CPPIB mandate, governance structure and investment policy can be found at **www.cppib.ca**.

CPP Investments

As at March 31, 2007, CPP investments totaled $116.6 billion. These investments consisted of $67.5 billion of public equities, $8.1 billion of private equities, $29.3 billion of fixed income securities, and $11.7 billion of real estate, inflation-linked bonds and infrastructure.

The CPP fund earned $13.1 billion for a return of 12.9 percent for the fiscal year ending March 31, 2007.

Investing for our Future

Due to its focus on a long-term investment horizon and the diversity necessary to outperform benchmarks, the CPPIB will maintain a stronger weighting in equities and alternative asset classes over fixed income assets. As well, CPP assets are allocated in a way that reflects the long-term funding requirements of the Plan.

Alongside the mostly passive $67.5 billion public equity portfolio, the CPPIB has unfunded commitments of approximately $11.7 billion for private equity and $1.7 billion for real estate and infrastructure.

Initially, as the private equity program grew, private equity investments were made through external fund managers. More recently, the CPPIB has expanded its capabilities to invest both through external funds and as a principal investor.

ike other major pension funds, the CPPIB is
ooking for opportunities to increase investments
hat track and surpass the general rate of inflation.
hese would include inflation-sensitive assets such
s: real estate, which contains mostly retail and
ommercial properties; infrastructure, with deals
riginating mostly in North America and Western
urope; and inflation-linked bonds.

egislation requires that the CPPIB hold public
neetings at least every two years in each of the nine
ncluded provinces in the CPP. The purpose of these
neetings is to present the most recent annual report
nd to provide the public with the opportunity to
sk questions about the policies, operations and
uture plans of the CPPIB. The last meetings were
eld in June, November and December of 2006.

Managing the CPP

Collecting and Recording Contributions

Contributions to the Canada Pension Plan (CPP) are paid on earnings between a minimum and a maximum amount. The minimum (which remains constant) is $3,500 and the maximum is adjusted annually to reflect the growth in the average Canadian industrial wage. The maximum amount of pensionable earnings as of January 1, 2007, was $43,700 (up from $42,100 in 2006). Contributions stop once a contributor reaches the age of 70 or begins to receive a CPP retirement pension or disability benefit.

The contribution rate in 2007 is 9.9 percent, equally split between employees and employers. People who are self-employed pay the full 9.9 percent. Employers and employees make approximately 94 percent of contributions; the remaining 6 percent comes from the self-employed. In 2006–07, contributions amounted to $32.4 billion.

All CPP contributions are remitted to the Canada Revenue Agency (CRA). CRA also assesses and verifies earnings and contributions, advises employers and employees of their rights and responsibilities, conducts audits, and reconciles reports and T4 slips. To verify that contribution requirements are being met, CRA applies a compliance and enforcement process that can vary from a computerized data match to an on-site audit. There are approximately 1.5 million existing employer accounts. During 2006–07, CRA conducted 50 129 examinations, concentrating on files with irregularities.

Overpayment of Benefits

Consistent with its mandate to manage the CPP effectively, HRSDC has procedures in place to detect benefit overpayments. During 2006–07, overpayments totaling $29 million were detected. Of this amount, $22 million was recovered and remission was granted of debts totaling $4 million.

Administrative Costs

In 2006–07, the cost to administer the CPP was approximately $574 million, with SDC accounting for the largest portion at $293 million and HRSDC at $17 million. CRA required approximately $135 million and Public Works and Government Services Canada (PWGSC) some $14 million, for services to the CPP. The Office of the Superintendent of Financial Institutions (OSFI), where the Office of the Chief Actuary is housed, accounted for about $1 million. The CPPIB reported $114 million in operating expenses.

CPP administrative expenses in 2006–07 represent 2.2 percent of the $26.1 billion in benefits paid. This ratio compares very favourably with that of other pension plans. CPP administrative costs also compare favourably with those of RRSPs. Table 1 (next page) presents the CPP's administrative expenditures for the last three years.

TABLE 1: CPP Administrative Costs 2004–05 to 2006–07

	Expenditures (in $ millions)		
Department/Agency	2004–05	2005–06	2006–07
SDC (formerly included with HRDC)	263	269	293
HRSDC (formerly included with HRDC)	10	21	17
CRA	96	101	135
CPPIB operating expenses	31	54	114
PWGSC	16	16	14
OSFI	1	1	1
Total	417	462	574

Improved Service Delivery
Service Canada

Service Canada is the Government of Canada's one-stop service delivery network. In partnership with other departments, agencies and levels of government, it provides Canadians with easy access to a growing range of government programs and services.

Service Canada is just a call, click or visit away. Our service delivery network consists of in-person offices, a national telephone information service at 1 800 O-Canada, and online services at **servicecanada.gc.ca**.

Among the biggest computer users in the world, Canadians are also among the biggest users of the Internet for government services. For example, Canadians increasingly use the Internet to carry out their transactions for Employment Insurance (EI), Canada Pension Plan (CPP) and other benefit programs.

At **servicecanada.gc.ca**, Canadians can find information on topics for seniors, apply for programs and benefits electronically, or find a list of Service Canada Centre locations near them. The information can be found by subject, department or alphabetically.

Reaching Out to Canadians

During 2006–07, Service Canada continued its efforts to help Canadians better understand public pensions and the retirement income system, and to encourage them to actively plan and prepare for their own retirement. Information on the CPP is available in print, on the Internet, in person at local offices, by phone, and at electronic kiosks in government offices and public buildings.

Personalized contact with clients continues to receive high priority. In 2006–07, Service Canada issued personal CPP Statements of Contributions to 536 335 individuals between the ages of 18 and 70. The statements were accompanied by information on the retirement income system in Canada and on how to apply for benefits online. An additional 19 149 personal Statements of Contributions were issued to individuals over age 70. The Statements were accompanied by an application form for a CPP retirement pension.

Recognizing Canada's diversity, Service Canada extended its reach to multilingual communities by providing information on its programs and services, including the CPP, in a number of languages other than English and French. These multilingual services were added to the 587 points of service, ranging from Service Canada Centres to outreach sites in rural and remote areas.

In 2006–07, Service Canada also initiated a client segmentation concept for services (e.g. seniors, workers, youth, families and children, and Aboriginal people). The segmentation approach allows Service Canada to better understand the needs of Canadians and to integrate its services according to similarities and trends identified within these groups.

Delivering Service

In 2006–07, Service Canada continued to modernize CPP program delivery. With the multi-year Information Technology Renewal project, staff now have access to a consolidated view of complete CPP and OAS client and benefit information, benefit

payment history and lifetime CPP contributions, as well as simple maintenance actions. In addition, fully automated adjudication (determination of eligibility and calculations of entitlement) has been introduced for CPP retirement benefits, and development is nearing completion for the remainder of CPP benefits, with implementation targeted for 2008–09. At the same time, Service Canada continues to focus on maintaining the existing CPP information technology systems.

In an effort to improve service delivery, Service Canada increased the number of points of service available, from 416 in March 2006 to 587 as of March 2007. These points of service include 327 Service Canada Centres, 204 outreach sites in rural and remote locations, and 56 community offices. In addition, Canadians were provided with more convenient and extended hours of service through the 1 800 O-Canada call centre; Service Canada Centres are open for business from Monday to Friday from 8:30 a.m. to 4:00 p.m.; and Canadians can find the CPP information they need day or night at **servicecanada.gc.ca**.

Processing Benefits

In 2006–07, a total of 614 173 CPP applications were processed. This included 233 830 retirement applications, 93 percent of which were paid within the first month of entitlement. During the same period, the department processed 63 860 disability initial applications. Decisions on 87 percent of all CPP disability initial applications, which are complex and require medical information, were made within 120 calendar days of receipt of the completed application. Improved communication with clients and their physicians helped staff make well-informed decisions and helped CPP disability applicants better understand the reasons for decisions.

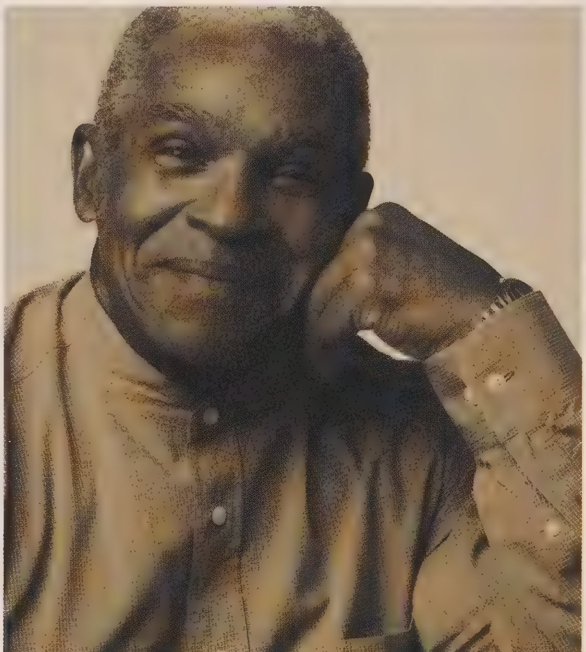


Table 2: Application Processing Statistics

National measures	Objective	2006–07 National
CPP retirement applications paid within the first month of entitlement	85%	93%
CPP disability initial decisions made within 120 calendar days	75%	87%
CPP disability reconsideration decisions made within 120 calendar days	70%	82%

Table 3: Telephone Service Statistics

National measures	Objective	2006–07 National
Clients served by a service agent within 180 seconds of placing a call*	95%	85%

* *The objective is to serve 95 percent of clients within 180 seconds.*

Looking to the Future Service Canada

nformation Technology Renewal Delivery System (ITR-DS)

Current systems supporting delivery of the Canada Pension Plan (CPP) program were designed decades ago for a mail and paper-based operation. Updating nformation systems that help deliver benefits is part of Service Canada's planned service delivery mprovements. Replacing aging legacy systems with new automated and rules-assisted technology will enable the evolution from a paper organization o an electronic one. Staff will work with one ool for both CPP and OAS. The new system will tandardize and automate benefit adjudication and entitlements while supporting new modes of service delivery. The new system is being developed in tages, and substantial new capabilities are already available. For example, staff can now process the majority of new CPP retirement benefits through the new rules-based system, ensuring accurate benefit payments to clients. Clients can also apply online or their CPP retirement benefits.

The system will improve the information available to clients and enhance the services that can be provided by staff. These improvements will further reduce the paper burden and the complexity of the application process, simplify he management of CPP contributions and support the relationship between staff and clients. In 2006–07, changes were introduced to Parliament through Bill C-36 that will position Service Canada for the next steps forward. One key change allows electronic applications and alternatives to client-supplied paper copies of evidentiary materials. Regulatory changes will have to be completed in 2007–08 in order to proceed with the development of new processes.

Online Service Delivery

Service Canada is implementing and continually improving on a number of self-service Web-based options. Clients will be able to make a wider range of inquiries and execute more transactions online, as well as access more integrated information on related benefits. Wider promotion of the Web-based CPP retirement application has led to increased usage.

View and Update Personal Information

Since June 2005, CPP clients have been able to access their personal information securely online. They can view and update mailing addresses, phone numbers and direct deposit information, as well as view their monthly payment amounts. In coming years, further enhancements will be made to allow clients to view and update more information. Bill C-36, which received Royal Assent in May 2007, will enable these activities to progress.

Streamlined and Automated CPP Statement of Contributions

CPP contributors can submit an online request to have their Statement of Contributions mailed to them. They can also view and print their personalized CPP Statement of Contributions information. With Bill C-36, the online version of a client's Statement of Contributions is now considered a legal document unless otherwise

contested. Clients will now be able to use the online service to request that an official copy be mailed to them more frequently than was permitted in the past.

Tax Information Slips Online

CPP clients can view their CPP T4 slips online, starting with those for the 2003 taxation year, including amendments. Clients can also choose to stop having paper tax slips mailed to them, and to view and print their T4 slips online instead.

Service Canada has promoted the use of online services through targeted mailing of promotional inserts in existing mass mailings, promotional messages within standard client correspondence, and improved navigation to online services on the Service Canada home page. Seasonal promotional activities are also undertaken where appropriate, such as promoting the online tax slip service during the tax-filing season. A significant increase in use of online services is anticipated when the next generation of seniors begins to apply for pension benefits.

The next step in the transition to an electronic-based organization is the implementation of the "My Service Canada Account." This online service will provide a single entry-point for several applications, including the CPP View and Update Personal Information, the online Statement of Contributions and the Tax Information Slips online.

Simplifying the Application Process

Service Canada has reviewed its current retirement benefit application processes so that clients can apply for benefits through streamlined, client-driven and efficient service.

The result is a simplified CPP retirement application form with an integrated Child Rearing Provision section. Further, most applicants no longer need to prove their date of birth with documentary evidence since the department now validates age through an electronic exchange with the Social Insurance Registry.

In the future, more improvements will be sought for the retirement application processes. Service Canada will also review and modify current application processes for other benefits such as death, survivor and disability. These improvements will reduce the requirements for additional data, provide options for making applications electronically, and consolidate some existing processes to increase timeliness, reduce paperwork and avoid duplication.

Bill C-36 and related regulatory changes will provide the foundation upon which to build these services.

REACHING ALL CANADIANS

n 2006–07, the Partnerships and Engagement Division of Human Resources and Social Development Canada (HRSDC) conducted a ational review with regional representatives and ervice delivery partners to better understand the arriers to CPP and OAS benefit take-up among riority populations (immigrants, Aboriginal people nd homeless and near-homeless seniors). This eview has helped HRSDC and Service Canada to onnect directly with partner service providers who re closer to the most difficult-to-reach populations. The department is developing several promising ilot initiatives to build partnerships with these ervice providers.

Over the past several years, HRSDC has made a oncerted effort to tell Canadians what they can xpect from their public pensions and how they hould prepare for their retirement. Striving to ommunicate as directly as possible with clients and hrough partners, the department will continue to mprove and personalize its program.

Human Resources and Social Development Canada
Ressources humaines et Développement social Canada

Canada Pension Plan

Consolidated Financial Statements for the year ended March 31, 2007

Canada

Management's responsibility for financial statements

The consolidated financial statements of the Canada Pension Plan have been prepared in accordance with Canadian generally accepted accounting principles for the public sector, by the management of Service Canada in agreement with the management of Human Resources and Social Development Canada (the Department).

Management is responsible for the integrity and objectivity of the information in the financial statements, including the amounts which must, of necessity, be based on best estimates and judgement. The financial information presented throughout the Annual Report is consistent with the financial statements.

In support of its responsibilities, management has developed and maintains systems of internal control and supporting procedures. They are designed to provide reasonable assurance that assets are safeguarded, recorded and properly maintained and transactions are properly authorized and are in accordance with the *Canada Pension Plan Act*, the *Financial Administration Act* and accompanying regulations. These controls include the establishment of an organizational structure that provides a well defined division of responsibilities and accountability, the selection and training of qualified staff, and the communication of policies and guidelines throughout the organization. Internal controls are reviewed and evaluated by both internal and external auditors in accordance with their respective audits. Management also reviews the recommendations of its internal and external auditors for improvements in internal controls.

The Auditor General of Canada, the external auditor of the Canada Pension Plan, has conducted an independent audit of the consolidated financial statements in accordance with Canadian generally accepted auditing standards and has reported to the Minister of Human Resources and Social Development .

Sherry Harrison, CMA
Comptroller
Human Resources and
Social Development Canada

Sylvie C. Lafontaine, CA
Chief Financial Officer
Service Canada

Janice Charette
Deputy Minister
Human Resources and
Social Development Canada

August 17, 2007

Auditor General of Canada
Vérificatrice générale du Canada

AUDITOR'S REPORT

To the Minister of Human Resources and Social Development

I have audited the consolidated statement of net assets of the Canada Pension Plan as at March 31, 2007 and the consolidated statements of changes in net assets and cash flow for the year then ended. These financial statements are the responsibility of the management of Human Resources and Social Development. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audit in accordance with Canadian generally accepted auditing standards. Those standards require that I plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In my opinion, these consolidated financial statements present fairly, in all material respects, the net assets of the Canada Pension Plan as at March 31, 2007 and the changes in its net assets and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

Sheila Fraser

Sheila Fraser, FCA
Auditor General of Canada

Ottawa, Canada
August 17, 2007

Canada Pension Plan

Consolidated Statement of Net Assets
As at March 31

	2007	2006
	(in millions of dollars)	
ssets		
ash (Note 8)	**56**	155
eceivables (Note 7)	**5,946**	3,439
nvestments (Schedule, Note 3)	**118,094**	99,196
ther Assets	**15**	8
	124,111	102,798
iabilities		
ccounts payable	**148**	41
ensions and benefits payable	**74**	62
ax deductions due to Canada Revenue Agency	**100**	96
nvestment liabilities (Schedule, Note 3)	**1,382**	775
mounts payable from pending trades (Schedule, Note 3)	**2,576**	703
	4,280	1,677
let assets	**119,831**	101,121

ontingencies (Note 13)

he accompanying notes and consolidated schedule are an integral part of these consolidated financial tatements.

pproved by:

Sherry Harrison, CMA
Comptroller
Human Resources and
Social Development Canada

Sylvie C. Lafontaine, CA
Chief Financial Officer
Service Canada

Janice Charette
Deputy Minister
Human Resources and
Social Development Canada

Canada Pension Plan

Consolidated Statement of Changes in Net Assets
for the year ended March 31

	2007	2006
	(in millions of dollars)	
Net assets, beginning of year	**101,121**	83,411
Increase		
Contributions	**32,355**	30,117
Net Investment income (Note 9)		
Realized gains	**9,540**	6,448
Unrealized (losses)/gains	**(542)**	3,239
Interest income	**1,988**	2,185
Dividend income	**1,666**	1,031
Other income	**417**	165
Investment management fees	**(25)**	(36)
	13,044	13,032
	45,399	43,149
Decrease		
Pensions and benefits		
Retirement	**18,679**	17,698
Survivors	**3,573**	3,466
Disability	**3,137**	3,111
Disabled contributor's child	**273**	269
Death	**260**	264
Orphan	**218**	218
Net overpayments	**(25)**	(49)
	26,115	24,977
Operating expenses (Note 10)	**574**	462
	26,689	25,439
Net increase in net assets	**18,710**	17,710
Net assets, end of year	**119,831**	101,121

The accompanying notes and consolidated schedule are an integral part of these consolidated financial statements.

Consolidated Statement of Cash Flow
for the year ended March 31

	2007	2006
	(in millions of dollars)	
Operating Activities		
Cash receipts		
Contributions	**32,107**	29,310
Interest on investments	**2,146**	2,274
Dividends on investments	**1,627**	989
Other investment income	**1,297**	2,357
Cash payments		
Pensions and benefits	**(26,151)**	(24,974)
Operating expenses	**(437)**	(496)
Investment management fees	**(37)**	(27)
Cash Flows from Operating Activities	**10,552**	9,433
Financing Activities		
Issuance of debt	**703**	441
Repayment of debt	**(235)**	(10)
Payment of interest on debt	**(64)**	(28)
Cash Flows from Financing Activities	**404**	403
Investing Activities		
Purchases		
Equities	**(81,422)**	(35,258)
Inflation sensitive investments	**(4,834)**	(8,718)
Fixed income investments	**(6,011)**	(17,046)
Money market securities	**(294,842)**	(332,728)
Premises and equipment	**(9)**	(4)
Disposals		
Equities	**80,231**	27,801
Inflation sensitive investments	**2,347**	1,307
Fixed income investments	**3,520**	17,623
Money market securities	**289,965**	334,569
Cash Flows used in Investing Activities	**(11,055)**	(12,454)
Net (decrease) in Cash	**(99)**	(2,618)
Cash at beginning of year	**155**	2,773
Cash at end of year	**56**	155

Canada Pension Plan

Consolidated Schedule of Investments
for the year ended March 31

	2007	2006
Equities	(in millions of dollars)	
Canada		
Public equities	14,800	20,003
Private equities	667	455
	15,467	20,458
Foreign		
Public equities	36,656	27,743
Private equities	7,436	3,995
Pooled funds	260	-
	44,352	31,738
Total equities	59,819	52,196
Nominal fixed income		
Bonds (Note 3d)	28,481	26,452
Money market securities	15,561	10,356
Total nominal fixed income	44,042	36,808
Inflation-sensitive assets		
Public real estate	1,409	1,178
Private real estate	5,441	3,676
Inflation-linked bonds	3,802	3,837
Infrastructure	2,181	350
Total inflation-sensitive assets	12,833	9,041
Total investments	116,694	98,045
Investment receivables		
Accrued interest	714	764
Derivatives receivables	519	259
Dividends receivables	167	128
Total investment receivables	1,400	1,151
Total investments and investments receivable	118,094	99,196
Investments liabilities		
Debt on private real estate properties	(1,174)	(664)
Derivatives liabilities	(208)	(111)
Total investments liabilities	(1,382)	(775)
Amounts receivable from pending trades	2,477	255
Amounts payable from pending trades	(2,576)	(703)
Net investments	116,613	97,973

1. Description of the Canada Pension Plan

) Description of the Canada Pension Plan

he Canada Pension Plan (CPP) is a federal/provincial plan established by an Act of Parliament in 1965.

he CPP began operations in 1966. It is a compulsory and contributory social insurance program operating ı all parts of Canada, except Quebec, which operates the Régime des rentes du Québec, a comparable rogram. The Plan's objective is to provide a measure of protection to workers and their families against the ɔss of earnings due to retirement, disability or death.

he Canada Pension Plan Investment Board (CPPIB) was established pursuant to the *Canada Pension Plan ıvestment Board Act*. The CPPIB is a federal Crown corporation, all of its shares are owned by her Majesty ne Queen in right of Canada.

he Minister of Human Resources and Social Development is responsible for the administration of the *anada Pension Plan* (under the CPP Act); the Minister of National Revenue is responsible for collecting ontributions. The Minister of Finance and his provincial counterparts are responsible for setting CPP ontribution rates, pension and benefit levels and funding policy. The CPP Investment Board is responsible ɔr managing amounts that are being transferred under Section 108.1 of the *Canada Pension Plan* and nterest on any debt securities transferred to the Board. It acts in the best interests of the beneficiaries and ontributors under the Act.

ı accordance with the CPP Act, the financial activities of the Canada Pension Plan are recorded in the CPP ccount (Note 8). The Plan's investments are held by the CPP Investment Fund (Note 4) and the CPP ıvestment Board (CPPIB). The financial transactions affecting the Account and the Investment Fund are overned by the CPP Act and regulations. The Investment Board's transactions are governed by the *Canada ension Plan Investment Board Act* and the accompanying regulations. The CPP Investment Board's assets re to be invested with a view to achieve a maximum rate of return without undue risk of loss, having regard ɔ the factors that may affect the funding of the CPP and its ability to meet its financial obligations on any iven business day.

he CPP Investment Board and its subsidiaries are exempt from Part I income tax under paragraphs 49(1)(d) and 149 (1) (d.2) of the *Income Tax Act (Canada)* on the basis that all of the shares of the CPP ıvestment Board and its subsidiaries are owned by Her Majesty the Queen in right of Canada or by a orporation whose shares are owned by Her Majesty the Queen in right of Canada, respectively.

he CPP Investment Board is designed to operate at arm's length from the government. It is required to be ccountable to the public, Parliament (through the federal Minister of Finance), and the provinces. It provides egular reports of its activities and the results achieved.

s stated in the CPP and CPPIB Acts, changes to these Acts require the approval of at least two-thirds of the rovinces having, in the aggregate, not less than two-thirds of the population of all included provinces.

) Financing

he CPP is financed by contributions and investment returns. Employers and employees pay contributions qually to CPP. Self-employed workers pay the full amount.

The CPP was designed initially to be financed on a pay-as-you-go basis, which means that the Plan would operate on a current basis with pensions and benefits being paid out of current contributions. With changes made to the Act in 1997, CPP is now intended to be funded on a "steady-state" basis – that is, combined employer-employee contributions of 9.9% of pensionable earnings. While the net asset value does not cover the actuarial present value of accrued pensions and benefits, it is expected to provide a capitalization level of 25% of the Plan's liability by the year 2025 as per the last triennial Actuarial Report issued in 2004.

The CPP Act provides that an actuarial report shall be prepared every three years for purposes of the review of the financial state of the CPP by the Minister of Finance and his provincial counterparts. The most recent triennial report, the Twenty-first Actuarial Report of the Chief Actuary as at December 31, 2003, was tabled on December 8, 2004. The report concluded that the CPP is financially sound and the 9.9% combined employee-employer contribution rate reached in 2003 is expected to be sufficient to sustain the Plan in the face of an aging population.

The CPP Act also provides that whenever a bill amending the CPP Act is introduced that would materially affect the estimates of the most recent triennial report, the Chief Actuary will prepare a report, using the same assumptions and basis as the triennial report, presenting how this bill would affect the estimates of the last triennial report. Following the introduction of Bill C-36, an act amending the CPP Act to relax the contributory requirements for disability and disabled contributors' child benefits, the Twenty-second Actuarial Report of the Chief Actuary as at December 31, 2003 was tabled on December 4, 2006. This report concludes that the CPP remains financially sound and that the 9.9% combined employer-employee contribution rate is expected to be sufficient to sustain the Plan.

A number of assumptions such as long term rate of return on assets, inflation rate, mortality rates, increase in salary and benefit rates, among other things, were used in the Twenty-first and Twenty-second Actuarial Reports. These assumptions reflect best estimates of future economic and demographic events. The next triennial actuarial report as at December 31, 2006 is expected to be completed by December 2007.

c) Net assets of the Plan

The net assets of the Plan are composed of the deposit with the Receiver General for Canada, bonds and other net assets held on behalf of the CPP by the Government of Canada and investments held by the CPPIB. They represent funds accumulated for the payment of pensions, benefits and operating expenses.

As at March 31, 2007, the value of net assets of the Plan is $119.8 billion (2006 – $101.1 billion). This amount represents approximately 4.6 times the total of pensions and benefits in 2007 (2006 - 4.0 times). According to the Twenty-first Actuarial Report, this is expected to grow to 5.6 times by 2021.

d) Pensions and benefits

Retirement pensions – A retirement pension is payable to each contributor at age 60 or older, according to the provisions of the Act. The monthly amount is equal to 25% of the contributor's average monthly pensionable earnings during the pensionable period. The amount may be reduced or increased depending upon whether the contributor applies for a retirement pension before or after age 65. This adjustment cannot exceed 30%. The maximum new monthly pension payable at age 65 in 2007 is $863.75 (2006 – $844.58).

Disability benefits – A disability benefit is payable to a contributor who is disabled, according to the provisions of the Act. The amount of the disability benefit to be paid includes a flat-rate portion and an amount equal to 75% of the earned retirement pension. The maximum new monthly disability benefit in 2007 is $1,053.77 (2006 – $1,031.05).

Survivor's benefits – A survivor's benefit is payable to the spouse or common-law partner (the beneficiary) of a deceased contributor, according to the provisions of the Act. For a beneficiary under the age of 65, the benefit consists of a flat-rate portion and an amount equal to 37.5% of the deceased contributor's earned retirement pension. A beneficiary between the ages of 35 and 45 who is not disabled or who has no dependent children receives reduced benefits. For beneficiaries aged 65 and over, the benefit is equal to

0% of the retirement pension granted to the deceased contributor. The maximum new monthly benefit ayable to a beneficiary in 2007 is $518.25 (2006 – $506.75).

isabled contributor's child and orphan benefits – According to the provisions of the Act, each child of a ontributor who is receiving disability benefits or a child of a contributor who is deceased is entitled to a enefit as long as the child is under the age of 18, or is between the ages of 18 and 25 and attending school ıll-time. The flat-rate monthly benefit in 2007 is $204.68 (2006 – $200.47).

eath benefits – According to the provisions of the Act, a death benefit is a one-time payment to, or on ehalf of, the estate of a contributor. The benefit amounts either to 10% of the maximum pensionable arnings in the year of death or six times the monthly retirement pension granted to the deceased contributor, /hichever is less. The maximum death benefit in 2007 is $2,500 (2006 – $2,500).

ensions and benefits indexation – As required by the Act, pensions and benefits are indexed annually ased on the Consumer Price Index for Canada. The rate of indexation for 2007 is 2.1% (2006 – 2.3%).

. Significant accounting policies

) Basis of presentation

hese financial statements are presented on a consolidated basis. They include the consolidated net assets, ıe consolidated changes in net assets and the consolidated cash flows of the CPP and the CPP Investment oard. These financial statements are prepared in accordance with Canadian generally accepted accounting rinciples for the public sector and conform to the disclosure and accounting requirements of the CPP Act.

hese consolidated financial statements do not provide information on the actuarial estimates required to ıeet future obligations of the CPP since the CPP Act does not require that the pensions and benefits be pre-ınded.

he CPP, which is under joint control of the Government of Canada and participating provinces, is not onsidered to be part of the reporting entity of the Government of Canada. Accordingly, its financial activities re not consolidated with those of the Government.

) Valuation of investments, investment receivables and investment liabilities

ıvestments, investment receivables and investment liabilities are recorded on a trade date basis and are tated at fair value. Fair value is the amount of the consideration that would be agreed upon in an arm's-ength transaction between knowledgeable, willing parties who are under no compulsion to act.

air value is determined as follows:

(i) Quoted market prices for publicly-traded equities and unit values for public equity and pooled funds are used to represent fair value for these investments. Unit values reflect the quoted market prices of the underlying securities. In the case where quoted market prices are not available or reliable, such as those for securities that are not sufficiently liquid to be used as a basis for fair value, fair value is determined using accepted industry valuation methods.

(ii) Private equity and infrastructure investments are either held directly or through ownership in limited partnership arrangements. The fair value for investments held directly is determined using accepted industry valuation methods. These methods include considerations such as earnings multiples of comparable publicly-traded companies, discounted cash flows and third party transactions, or other events that would suggest a change in the value of the investment. In the case of investments held through a limited partnership, fair value is generally determined

based on carrying values and other relevant information reported by external managers using accepted industry valuation methods. In the first year of ownership, cost, which includes capitalized management fees, is generally considered to be an appropriate estimate of fair value for private equity and infrastructure investments unless there is evidence of a significant change in value.

(iii) Quoted market prices are used to represent the fair value for marketable bonds. Where quoted market prices are not available, fair value is calculated using discounted cash flows based on current market yields of instruments with similar characteristics.

(iv) Fair value for non-marketable Canadian federal, provincial and territorial government bonds is calculated using discounted cash flows based on current market yields of instruments with similar characteristics, adjusted for the non-marketability and rollover provisions of the bonds.

(v) Money market securities are recorded at cost, which, together with accrued interest income, approximates fair value.

(vi) Quoted market prices are used to represent the fair value for public real estate investments.

(vii) The fair value of private real estate investments is determined using accepted industry valuation methods, such as discounted cash flows and comparable purchase and sales transactions. Debt on private real estate investments is valued using discounted cash flows based on current market yields for instruments with similar characteristics. In the first year of ownership, cost is generally considered to be an appropriate estimate of fair value for private real estate investments unless there is evidence of a significant change in value.

(viii) Quoted market prices are used to represent the fair value for inflation-linked bonds.

(ix) Fair value for exchange-traded derivatives, which include equity, bond and interest futures, is based on quoted market prices. Fair value for over-the-counter derivatives, which include equity swaps, inflation-linked bond swaps and foreign exchange forward contracts, is determined based on the quoted market prices for underlying instruments.

c) Contributions

Contributions include CPP contributions earned for the year. The Canada Revenue Agency (CRA) collects contributions and measures them using the assessment of tax returns. In determining the amount of contributions earned for the year, the Agency considers cash received and contributions assessed, and makes an estimate for contributions related to tax returns not yet assessed. This estimate is subject to review and adjustments. Adjustments, if any, are recorded as contributions in the year they are known.

d) Investment income

Investment income is recorded on the accrual basis and includes realized gains and losses from investments, unrealized gains and losses on investments held at the end of the year, dividend income (recognized on ex-dividend date), interest income and net operating income from private real estate investments.

Realized gains and losses on investments sold during the year represent the difference between sale proceeds and cost, less related costs of disposition. Unrealized gains and losses represent the difference between the fair value and cost of the investments at the end of the year. The current year unrealized gains and losses represent the year-over-year change in this difference.

) Translation of foreign currencies

ransactions denominated in foreign currencies are translated into Canadian dollars at exchange rates revailing on the transaction date. Investments and other monetary assets and liabilities denominated in oreign currencies are translated into Canadian dollars at exchange rates prevailing on the year end date with ny resulting gain or loss being included in investment income.

Pensions and benefits

ensions and benefits are recorded when payable.

) Tax deductions due to Canada Revenue Agency

ax deductions due to CRA consists primarily of voluntary and non-resident taxes withheld from pensions nd benefit payments to CPP beneficiaries.

) Net overpayments

let overpayments are composed of overpayments of pensions and benefits that were established during ne year less remissions of debts granted.

Operating expenses

)perating expenses are recorded in the year to which they relate.

Use of estimates

he preparation of consolidated financial statements in accordance with Canadian generally accepted ccounting principles for the public sector requires management to make estimates and assumptions that ffect the reported values of assets and liabilities as at the date of the financial statements, and income and xpenses during the reporting period. Significant estimates and judgments are required principally in etermining the reported estimated contributions, allowance for doubtful accounts, contingencies and fair alues of investments since these determinations include estimates of expected future cash flows, rates of eturn and the impact of future events. Actual results could differ significantly from those estimates.

) Future Changes in accounting policy

April 2005, the CICA issued section 3855, Financial Instruments – Recognition and Measurement, which is ffective for fiscal years beginning on or after October 1, 2006. As the CPP Investment Board qualifies as an ıvestment Company and it reports its investments at fair value in accordance with AcG-18, Investment ompanies, only certain aspects of section 3855 are applicable to the CPP Investment Board.

ffective April 1, 2007, the CPP Investment Board will adopt the fair value measurement considerations of ection 3855. The impact to the CPP Investment Board is a change in the way certain investments are alued, expensing of transaction costs when incurred and applying the effective interest method in ccounting for interest income on bonds. On April 1, 2007, the investments of the CPP Investment Board will e remeasured to reflect the new valuation standards. This transition adjustment is not expected to have a ıaterial impact on the CPP Investment Board's financial position.

he adoption of the new standard by CPPIB is not expected to have a material impact on the Canada ension Plan's financial statements.

3. Investments and investment liabilities

The CPP Investment Board has established investment policies in accordance with the CPPIB regulations which set out the manner in which their assets shall be invested. In setting the policies, the CPP Investment Board takes into consideration certain assets that are held outside of the CPP Investment Board and that are in the process of being transferred to the CPP Investment Board as set out in the following paragraph:

The CPP Act and an administrative agreement between Her Majesty the Queen in right of Canada and the CPP Investment Board (the "Agreement") together provide for the transfer of certain specified CPP assets, currently administered by the federal government, to the CPP Investment Board. These assets consist of the remaining portfolio of non-marketable federal, provincial and territorial bonds that have been transferred to the CPP Investment Board at the rate of 1/36th every month since May 1, 2004. The last 1/36th, totalling $630 million (including $16 million of accrued interest) at fair market value as at March 31, 2007, will be transferred to the CPP Investment Board on April 1, 2007 (see Note 3d).

a) Derivative contracts

A derivative is a financial contract, the value of which is derived from the value of underlying assets, indexes, interest rates or currency exchange rates. The fair value of these contracts is reported as derivative receivables and derivative liabilities on the consolidated schedule of Investments. Derivative exposure includes the fair value plus the notional amount of the contract.

The CPP Investment Board uses the following types of derivative instruments as described below:

Equity and inflation-linked bond swaps
Swaps are over-the-counter contractual agreements between two counterparties to exchange financial returns with predetermined conditions based on notional amounts. Swaps are used for yield enhancement purposes or to adjust exposures to certain equities and inflation-linked bonds without directly purchasing or selling the underlying asset. Swap contracts create credit risk exposure due to the possible inability of counterparties to meet the terms of the contracts. There is also risk arising from exposure to movements in equity values, interest rates and foreign rates, as applicable (see Note 5).

Equity, interest rate and bond futures
Futures are standardized contracts transacted on an exchange to purchase or sell a specified quantity of equities, interest rate sensitive financial instruments or bonds at a predetermined price and date in the future. Futures are used to adjust exposure to specified equities, interest rate sensitive financial instruments and bonds without directly purchasing or selling the underlying asset. The primary risks associated with futures contracts are related to the exposure to movements in equity values, interest rates and foreign exchange rates, as applicable. Credit risk on exchange-traded futures is limited, as these transactions are executed on regulated exchanges, each of which is associated with a well-capitalized clearing house that assumes the obligations of both counterparties (see Note 5).

Foreign exchange forward contracts
Foreign exchange forward contracts are over-the-counter contractual agreements negotiated between two counterparties to exchange a specified amount of one currency for a specified amount of a second currency on a predetermined date in the future. Foreign exchange forward contracts are used to manage exposures to currencies other than the Canadian dollar. The primary risks associated with foreign exchange forward contracts arise from exposure to movements in foreign exchange rates and from the possible inability of counterparties to meet the terms of the contract (see Note 5).

All derivative contracts have a term of maturity of one year or less.

Notional amounts of derivative contracts represent the contractual amounts to which a rate or price is applied for computing the cash flows to be exchanged. The notional amounts are used to determine the returns and fair value of the contracts and are a measure of the exposure to the asset class to which the contract relates. They are not recorded as assets or liabilities on the balance sheet. Notional amounts do not represent the potential gain or loss associated with the market risk and are not indicative of the credit risk associated with a derivative contract.

The notional amounts and fair value of derivative contracts held as at March 31 are as follows:

	As at March 31, 2007				For the Year Ended March 31, 2007	
n millions of dollars)	Notional Amount	Gross Positive Fair Value	Gross Negative Fair Value	Net Fair Value	Average Gross Positive Fair Value[1]	Average Gross Negative Fair Value[1]
quity swaps	14,435	373	(134)	239	274	(156)
quity futures	1,797	1	(2)	(1)	4	(4)
oreign exchange forward contracts	19,170	145	(72)	73	132	(147)
nflation-linked bond swaps	-	-	-	-	-	-
nterest rate and bond futures	-	-	-	-	-	(1)
otal	35,402	519	(208)	311	410	(308)

	As at March 31, 2006				For the Year Ended March 31, 2006	
n millions of dollars)	Notional Amount	Gross Positive Fair Value	Gross Negative Fair Value	Net Fair Value	Average Gross Positive Fair Value[1]	Average Gross Negative Fair Value[1]
quity swaps	8,874	213	(44)	169	93	(45)
quity futures	1,047	1	(3)	(2)	3	(15)
oreign exchange forward contracts	6,184	45	(59)	(14)	24	(43)
nflation-linked bond swaps	126	-	(5)	(5)	4	(5)
nterest rate and bond futures	-	-	-	-	-	-
otal	16,231	259	(111)	148	124	(108)

[1] Determined using month-end values

b) Private equity investments

Private equity investments are generally made directly or through ownership in limited partnership arrangements, which have a typical term of 10 years. The private equity investments represent equity ownerships or investments with the risk/return characteristics of equity.

With respect to limited partnership arrangements, the CPP Investment Board advances capital to the limited partnerships, a portion of which, commonly referred to as management fees, is used by the general partners to select and provide ongoing management support to the underlying companies. Management fees generally vary between 1% and 2% of the total amount committed to the limited partnerships, and are included as part of the CPP Investment Board's cost of the investments. During the year ended March 31, 2007, management fees of $131 million (2006 – $87 million) were paid to the limited partnerships and recorded as part of the cost of the investments. As discussed more fully in Note 2b, the carrying values of these investments are reviewed quarterly and any resulting adjustments are reflected as unrealized gains or losses in investment income (see Note 9).

c) Inflation-sensitive assets

i. The CPP Investment Board obtains exposure to real estate through investments in publicly-traded securities and privately held real estate.

Private real estate investments are held by a wholly-owned subsidiary and are managed on behalf of the CPP Investment Board by external advisors and managers through co-ownership arrangements. As at March 31, 2007, the subsidiary's share of these investments includes assets of $5,441 million (2006 – $3,676 million) and $1,174 million of secured debt (2006 – $664 million), with a weighted average fixed interest rate of 6.2 per cent and terms to maturity of one to 20 years.

Included in the private real estate are investments in joint ventures. The CPP Investment Board's proportionate interest in joint ventures at March 31 is summarized as follows:

Proportionate share of net assets (in millions of dollars)	**2007**	**2006**
Assets	**4,790**	3,312
Liabilities	**(1,174)**	(664)
	3,616	2,648

Proportionate share of net income (in millions of dollars)	**2007**	**2006**
Revenue	**484**	273
Expenses	**(325)**	(183)
	159	90

ii. The terms to maturity of the inflation-linked bonds as at March 31 are as follows:

	2007						**2006**	
	Terms to Maturity							
(in millions of dollars)	Within 1 year	1 to 5 years	6 to 10 years	Over 10 years	Total	Average Effective Yield	Total	Average Effective Yield
Inflation-linked bonds	-	332	560	2,910	**3,802**	**3.3%**	3,837	4.8%

iii. Infrastructure investments are generally made directly, but can also occur through limited partnership arrangements that have a typical term of 10 years. Direct investments do not have management fees, while management fees for limited partnership infrastructure investments are treated similarly to private equity management fees as discussed in Note 3b). During the year ended March 31, 2007, management fees paid to the limited partnerships were $4.7 million (2006 – $5.4 million).

d) Bonds

Bonds consist of marketable and non-marketable bonds as follows:

	2007	2006
	(in millions of dollars)	
Marketable bonds		
Government of Canada	**2,200**	-
Provincial	**1,110**	-
Government corporations	**920**	-
Total marketable bonds	**4,230**	-
Non-marketable bonds		
Government of Canada	**1,888**	3,354
Provincial and territorial	**22,363**	23,098
Total non-marketable bonds	**24,251**	26,452
Total bonds	**28,481**	26,452

The following table provides information on disposals, re-investments, unrealized gains(losses) of non-marketable bonds held by the CPP for the CPP Investment Board and the CPP:

Non-marketable bonds
(in millions of dollars)

	March, 31 2006 at cost	Disposals	Re-Investments	**March, 31 2007 at cost**	**March, 31 2007 at fair value**	March, 31 2006 at fair value
CPP Investment Fund's share	**8,355**	600	-	**563**	**614**	9,164
CPP Investment Board's share	***15,944**	2,275	1,120	**21,981**	**23,637**	17,288
	24,299	**2,875**	**1,120**	**22,544**	**24,251**	**26,452**

* CPP transferred to CPP Investment Board bonds with a cost of $7,193 million during the year ending March 31, 2007 ($8,028 million – 2006).

The transfer to the CPP Investment Board of the CPP portfolio of non-marketable federal, provincial and territorial bonds began on May 1, 2004. Bonds of $8 billion based on fair market value at the time of transfer were transferred during the year ended March 31, 2007.

The non-marketable bonds issued by the provinces and territories and purchased by the CPP prior to 1998 contained a rollover provision which will permit these issuers, at their option, to roll over the bonds for a further 20-year term at a rate based on capital markets borrowing rates existing at the time of rollover. The non-marketable bonds are also redeemable at the option of the issuers for redemption amounts calculated in accordance with Section 110 of the *Canada Pension Plan Act.*

During the year, all disposals of bonds were made, at maturity date, at face value. The bonds are redeemable in whole or in part before maturity. The provinces and territories are permitted to redeem their bonds held by the CPP Investment Fund prior to their maturity at a value equivalent to market value. No bonds were redeemed by the provinces and the territories prior to maturity during the year ended March 31, 2007 (2006 – none).

Effective June 2005, the Agreement was amended to permit the CPP Investment Board to purchase replacement bonds directly from a province or territory upon the maturity of the non-marketable bonds issued by the provinces and territories prior to 1998, subject to the relevant province or territory having entered into an agreement with the CPP Investment Board. The maximum term of such securities is 30 years including rollover periods. The issuer may elect to have the CPP Investment Board purchase a replacement debt security or securities in a total principal amount not exceeding the principal amount of the maturing security for a term of not less than five years and not greater than 30 years. Such replacement bonds contain rollover provisions which will permit the issuer, at its option, to roll over the debt security for successive terms of not less than five

years and subject in all cases to the maximum 30 years outside maturity date. The replacement bonds are also redeemable at the option of the provinces or territories prior to maturity. Agreements between the CPP Investment Board and the relevant provinces or territories were effective commencing July 1, 2005.

The following schedule presents the fair value of the bonds by maturity dates and the average annual rate of return on bonds currently held based on current effective yields for similar type bonds:

	2007		2006	
	(in millions of dollars)			
	Investments at fair value	**Effective yield**	Investments at fair value	Effective yield
Investments maturing				
Within 1 year	**2,125**	**4.87 %**	2,837	4.71 %
1 – 5 years	**9,396**	**4.95 %**	11,965	5.02 %
Over 5 years	**12,730**	**4.98 %**	11,650	5.17 %
Total – Investments	**24,251**		26,452	
Average effective yield on investments		**4.96 %**		5.05 %

e) Commissions

Commissions are paid to brokers on purchases and sales of publicly traded equities. Commissions on purchases are included as part of the cost of publicly-traded equities. Commissions on sales are deducted from realized gains and added to losses as a cost of disposition. During the year ended March 31, 2007, the CPP Investment Board paid total brokerage commissions of $39 million (2006 – $28 million).

f) Securities lending

The CPP Investment Board engages in securities lending to enhance portfolio returns. Credit risk associated with securities lending is mitigated by requiring the borrower to provide daily collateral in the form of readily marketable investments of greater market value than the securities loaned. As at March 31, 2007, the CPP Investment Board's investments include securities loaned with an estimated fair value of $3,047 million (2006 – $1,847 million). The fair value of collateral received in respect of the securities loaned is $3,202 million (2006 – $1,942 million).

4. Investments held by the CPP Investment Fund

The Canada Pension Plan Investment Fund was established in the accounts of Canada by the CPP Act to record the Plan's investments in bonds of the provinces, territories and Canada. The CPP Investment Fund's bond portfolio is administered by the federal Department of Finance.

In accordance with the amended legislation and the related administrative agreement, the bonds held by the CPP Investment Fund are being transferred to the CPP Investment Board over a three year period. As at March 31, 2007, 35/36th of the Investment Fund has been transferred to the CPP Investment Board. The fair value of the bonds at the moment of the transfers total up to approximately $26 billion (2006 – 23/36th for approximately $18 billion). Once all the bonds are transferred to the CPP Investment Board in April 2007, the CPP Investment fund will cease to exist.

For further bond details see Note 3d).

5. Investment risk management

nvestments may be exposed to a variety of financial risks: price risk (including currency risk, interest rate isk and market risk), credit risk and liquidity risk. The CPP Investment Board manages financial risks in accordance with the *Canada Pension Plan Investment Board Act*, regulations and the investment policies. In addition, derivatives are used, where applicable, to manage certain risk exposures (See Note 3a).

Currency Risk: The CPP is exposed to currency risk through holdings of investments in various currencies. Fluctuations in the relative value of foreign currencies against the Canadian dollar can result in a positive or negative effect on the fair value of investments. The net underlying currency exposures, after allocating oreign currency derivatives, as at March 31 are as follows:

in millions of dollars)	**2007**		2006	
Currency	**Net Exposure**	**% of Total**	Net Exposure	% of Total
Canadian Dollar	**69,559**	**59**	63,802	66
United States Dollar	**23,502**	**20**	18,771	19
Euro	**8,744**	**7**	5,900	6
Japanese Yen	**5,299**	**5**	3,370	3
British Pound Sterling	**4,166**	**4**	3,266	3
Swiss Franc	**1,167**	**1**	760	1
Australian Dollar	**1,799**	**2**	893	1
Other	**2,378**	**2**	1,211	1
	116,614	**100**	97,973	100

Interest Rate Risk: Interest rate risk refers to the effect on the fair value of investments due to fluctuations in market interest rates. The fair value of the CPP marketable, non-marketable and inflation-linked bonds and debt on private real estate properties is directly affected by changes in interest rates. At March 31, 2007, should nominal interest rates have increased/decreased by 1%, the fair value of the bonds would decrease/increase by 7% (2006 – 7%).

Market Risk: Market risk is the risk that the value of an investment will fluctuate as a result of changes in market prices, whether those changes are caused by factors specific to the individual investment or factors affecting all securities traded in the market. The CPP manages market risk by investing across a wide spectrum of asset classes and investment strategies to earn a diversified risk premium at the total fund, based on risk limits established in the investment policies.

Credit Risk: Credit risk refers to the risk of financial loss due to a counterparty failing to meet its contractual obligations. The CPP limits credit risk by dealing with counterparties that have a minimum credit rating of A or R-1 (short-term) as determined by a recognized credit rating agency, where available, or as determined through an internal credit rating process. Credit exposure to any single counterparty is limited to maximum amounts as specified in the investment policies.

Liquidity Risk: Liquidity risk is the risk of being unable to generate sufficient cash or its equivalent in a timely and cost-effective manner to meet commitments as they come due. The CPP is exposed to liquidity risk through its responsibility to pay benefits on a timely basis. The CPP mitigates liquidity risk through its unsecured credit facilities (see Note 6).

6. Credit facilities

The CPP Investment Board maintains $1.5 billion (2006 - $1.5 billion) of unsecured credit facilities to meet potential liquidity requirements. As at March 31, 2007, the total amount drawn on the credit facilities is $nil (2006 – $nil).

7. Receivables

	2007	2006
	(in millions of dollars)	
Receivables		
Contributions	**3,333**	3,085
Régime des rentes du Québec	**100**	49
Beneficiaries		
Balance of pensions and benefits overpayments	**89**	86
Allowance for doubtful accounts	**(53)**	(50)
Amounts receivable from pending trades	**2,477**	255
Other	**-**	14
	5,946	3,439

The Department has procedures to detect overpayments. During the year, overpayments totalling $29 million (2006 – $53 million) were established and remissions of debts totalling $4 million (2006 – $4 million) were granted. A further $22 million was recovered (2006 – $45 million).

8. Canada Pension Plan Account

The CPP Account was established in the accounts of Canada by the CPP Act to record the contributions, interest, pensions, benefits and operating expenses of the Plan. It also records the amounts transferred to or received from the CPP Investment Fund and the CPP Investment Board. As at March 31, 2007, the Deposit with the Receiver General for Canada is $54 million (2006 - $151 million) and CPPIB's cash is $2 million (2006 - $4 million) for a total of $56 million (2006 - $155 million) in the consolidated statement of net assets and the consolidated statement of cash flow.

9. Net investment income

Investment income is reported net of external investment management fees. Investment management fees in respect of publicly-traded investments are expensed as incurred. These fees include an incentive portion that fluctuates with investment performance. Investment management fees for private real estate

nvestments are deducted by the asset manager before the CPP Investment Board receives its share of net operating income from the properties (See Notes 3b and 3c).

Net investment income by asset class and after giving effect to derivative contracts and investment receivables and liabilities for the year ended March 31 is as follows:

	2007	2006
	(in millions of dollars)	
Equities[1]		
Canada		
Public equities	**3,175**	7,567
Private equities	**77**	(13)
	3,252	7,554
Foreign		
Public markets	**4,955**	3,054
Private markets	**1,837**	585
Pooled funds	**(1)**	-
	6,791	3,639
Less : External investment management fees[2]	**(10)**	(30)
	10,033	*11,163*
Nominal Fixed Income[3]		
Bonds	**1,431**	1,283
Money market securities	**98**	41
	1,529	*1,324*
Inflation-sensitive assets		
Public real estate[4]	**453**	298
Private real estate[5]	**855**	183
Inflation-linked bonds	**30**	57
Infrastructure	**150**	(8)
	1,488	530
Less: External investment management fees[2]	**(15)**	(6)
	1,473	*524*
Interest on operating balance	***9***	*21*
Total net investment income[6]	**13,044**	13,032

1 Includes unrealized losses of $922 million (2006 – unrealized gains of $3,715 million), realized gains of $9,333 million net of external investment management fees (2006 – realized gains of $6,449 million net of external investment management fees), dividends of $1,615 million (2006 – $993 million) and securities lending income of $7 million (2006 – $6 million).

2 Investment management fees do not include capitalized management fees of $131 million (2006 – $87 million) for private equities and $4.7 million (2006- $5.4 million) for infrastructure.

3 Includes interest income of $1,988 million (2006 – $2,185 million), realized losses of $75 million (2006 – realized losses of $31 million) and unrealized losses of $375 million (2006 – unrealized losses of $809 million).

4 Includes unrealized gains of $133 million (2006 – unrealized gains of $260 million), realized gains of $269 million (2006 – realized losses of $0.3 million) and dividends of $51 million (2006 – $38 million).

5 Includes private markets real estate operating income of $230 million (2006 – $110 million), which is net of interest expense of $63 million (2006 – $42 million), unrealized gains of $622 million (2006 – unrealized gains of $73 million) and realized gains of $3 million (2006 - $nil).

6 Includes foreign exchange gains of $1,053 million (2006 – foreign exchange losses of $1,679 million).

10. Operating expenses

	2007	2006
	(in millions of dollars)	
General operating expenses	**257**	222
Salaries and benefits	**304**	232
Professional and consulting fees	**13**	8
Total Operating expenses	**574**	462

11. Net Assets and Changes in Net Assets for accountability purposes

The administration of the Canada Pension Plan's assets and activities is shared between various government of Canada's departments and the Canada Pension Plan Investment Board (CPPIB). The CPPIB is responsible for investing the majority of the Plan's assets, while the Government of Canada, through various federal departments, manages the remainder of the assets, as well as the collection of the CPP contributions and the administration and payments of the CPP benefits. For accountability purposes, the following table presents summary information on the levels of assets and liabilities and sources of income and expenses managed by each the GoC and the CPPIB.

	2007			2006		
	GoC	CPPIB	**Total**	GoC	CPPIB	**Total**
			(in millions of dollars)			
Assets	4,152	119,959	**124,111**	12,750	90,048	**102,798**
Liabilities	256	4,024	**4,280**	161	1,516	**1,677**
Net assets	3,896	115,935	**119,831**	12,589	88,532	**101,121**
Income :						
Contributions	32,355	-	**32,355**	30,117	-	**30,117**
Investment income	256	12,788	**13,044**	839	12,193	**13,032**
	32,611	12,788	**45,399**	30,956	12,193	**43,149**
Expenses :						
Pensions and benefits	26,115	-	**26,115**	24,977	-	**24,977**
Operating expenses	460	114	**574**	408	54	**462**
	26,575	114	**26,689**	25,385	54	**25,439**
Increase in net assets	6,036	12,674	**18,710**	5,571	12,139	**17,710**

Pursuant to Section 108.1 of the *CPPIB Act* and the Agreement dated as of April 1, 2004, amounts not required to meet specified obligations of the CPP are transferred to the CPPIB. The funds originate from employer and employee contributions to the CPP, proceeds of maturing and redeemed government bonds held by the GoC on behalf of the CPP and interest income generated from this portfolio.

CPP transfers include an interest in the bond portfolio administered by the GoC for the CPP and a portion of the amount on deposit with the Receiver General. In September 2004, the CPPIB assumed responsibility for

providing cash investment services to the CPP, including periodic return, on at least a monthly basis of funds required to meet expenses and benefits.

During the year ended March 31, 2007, a total of $33.5 billion was transferred to the CPPIB which include bonds of $8.0 billion based on fair market value at the time of transfer and cash of $25.5 billion. During the same year a total of $18.8 billion was returned to the CPP to meet its liquidity requirements.

Transaction total for the year

	2007	2006
	(in millions of dollars)	
Canada Pension Plan Investment Board		
Accumulated transfers to CPPIB, beginning of year	**91,795**	57,296
Transfers of bonds titles and accrued interest	**8,018**	9,201
Transfers of funds to CPPIB	**25,476**	25,298
Accumulated transfers to CPPIB, end of year	**125,289**	91,795
Accumulated transfers from CPPIB, beginning of year	**(23,355)**	(6,669)
Transfers of funds from CPPIB	**(18,765)**	(16,686)
Accumulated transfers from CPPIB, end of year	**(42,120)**	(23,355)
Accumulated net transfers to CPPIB	**83,169**	68,440

12. Commitments

The CPP Investment Board has committed to enter into investment transactions, which will be funded over the next several years in accordance with the agreed terms and conditions. As at March 31, 2007, the remaining commitments total $13.4 billion (2006 – $8.3 billion).

As at March 31, 2007, the CPPIB has made lease commitments of $54.9 million (2006 – $26 million) over the next seven years.

13. Contingencies

a) Appeals relating to the payment of pensions and benefits

At March 31, 2007, there were 7,996 (8,226 in 2006) appeals relating to the payment of CPP pensions and benefits. These contingencies are estimated at an amount of $88 million ($79 million in 2006). Any award made in favour of beneficiaries will be accounted for as an expense of the period in which the amount becomes determinable.

b) Class action

A class action was filed against the CPP for discrimination against survivors whose same-sex common-law partners died on or after April 17, 1985 and before January 1, 1998.

On March 1, 2007, the Supreme Court of Canada rendered its decision and ruled that class members are entitled to receive CPP survivor's pension. The arrears payment is limited to 11 months. It is expected that

the parties will appear before the Ontario Superior Court of Justice to resolve outstanding administrative issues, including the interest rates to be applied.

An amount of $13.5 million was recognized in the CPP 2006-07 financial statements for the estimated obligation at March 31, 2007.

c) Other claims and legal proceedings

In the normal course of operations, the CPP is involved in various claims and legal proceedings other than the class action described in 13b). While the total amount claimed in these actions may be significant, their outcomes are not determinable. The CPP records an allowance for claims and legal proceedings when it is likely that there will be a future payment and a reasonable estimate of the loss can be made. No such allowance was recognized in the financial statements for the 2006-07 and 2005-06 fiscal years for these claims and legal proceedings.

d) Guarantees and indemnifications

The CPP Investment Board provides indemnifications to its officers, directors and, in certain circumstances, to various counterparties. The CPP Investment Board may be required to compensate these parties for costs incurred as a result of various contingencies such as changes in laws and regulations and litigation claims. The contingent nature of the indemnification agreements prevents the CPP Investment Board from making a reasonable estimate of the maximum potential payments the CPP Investment Board could be required to make. To date, the CPP Investment Board has not received any claims nor made any payments for such indemnifications.

14. Related party transactions

In addition to the information already disclosed in the other notes to the consolidated financial statements, the CPP has $3,333 million (2006 - $3,085 million) of contributions receivable from the Canada Revenue Agency.

The CPP enters into transactions with the Government of Canada in the normal course of business, which are recorded at the exchange value. The costs are based on estimated allocations of costs and are charged to the CPP in accordance with a memorandum of understanding.

Transaction total for the year

	2007	2006
	(in millions of dollars)	
Pension and benefit delivery, accommodation and corporate services		
Social Development Canada	**293**	269
Human Resources and Skills Development Canada	**17**	21
	310	290
Collection of contributions		
Canada Revenue Agency	**135**	101
Cheque issue and computer services		
Public Works and Government Services Canada	**14**	16
Actuarial services		
Office of the Superintendent of Financial Institutions	**1**	1
	460	408

5. Comparative figures

ertain comparative figures have been reclassified to conform to the current year's presentation.